

Taxation of the financial sector

Final Report

Volume 1

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TABLE OF CONTENTS

ABBREVIATIONS AND ACRONYMS iv
ABSTRACT 1
1. Introduction 2
1.1 Purpose of the study 4
1.2 Subject of the study – the tax framework for the financial sector in the EU 5
1.3 Approach and methodology of the study 7
PART A – Assessment of the current situation 12
2. Business model analysis and typology 13
2.1 The typology of activities in the financial sector 13
2.2 Fintech 15
2.3 Correspondence between business activities and VAT, statistical classification 17
3. VAT and the financial sector 19
3.1 Legal analysis of the EU VAT framework 19
3.2 VAT/GST regime for financial services in third countries 46
4. Sectoral analysis 61
4.1 Introduction 61
4.2 Economic importance of the financial sector 63
4.3 Banking services 66
4.4 Insurance services 79
4.5 Other financial services (i.e., investment services) 88
4.6 Summary of key findings 95
5. VAT liability and compliance analysis 97
5.1 Introduction 97
5.2 VAT liability 99
5.3 VAT payments based on tax returns 109
5.4 VAT non-compliance and forgone revenue 110
5.5 Summary 113
6. Mapping and analysis of sectoral taxes applied to the Financial Sector 115
6.1 Introduction 115
6.2 Taxes on the sale of financial and insurance products 117
6.3 Financial transaction taxes 120
6.4 Financial institution levies 121
6.5 Payroll taxes 123

6.6 Additional corporate income taxes 123
6.7 Windfall taxes 124
6.8 Summary 127
7. Economic analysis of the tax framework for financial services 128
7.1 Economic impacts of different approaches to VAT rules for the financial services 128
7.2 Analysis of compliance costs 133
7.3 Overall economic impacts on the taxation of financial services 144
8. Taxes and the regulatory framework 160
8.1 Interactions of the tax and regulatory frameworks 160
8.2 The tax treatment of contributions to the Single Resolution Fund and Deposit Guarantee Scheme 165
PART B – Problem analysis, policy objectives and considerations 171
9. Problem analysis 172
9.1 Introduction 172
9.2 Drivers 183
9.3 Problems 191
9.4 Consequences 201
10. Policy objectives 208
11. Policy considerations 210
11.1 Introduction 210
11.2 Building block 1 - Modernisation and simplification of the current rules for VAT 212
11.3 Building block 2 - Introduction of measures to reduce non-deductible VAT for the financial sector 216
11.4 Building block 3 - Revisiting the VAT exemption for financial services and introducing harmonisation measures in sectoral taxes 219
11.5 Intervention logic 229
PART C – Assessment of possible policy changes 231
12. Building block 1: Modernisation and simplification of the current rules for VAT 235
12.1 Policy consideration 1A: Modernisation of the definitions of the VAT exemption 235
12.2 Policy consideration 1B: Simplifying and harmonising the rules on proportional deduction 246
13. Building block 2: Introduction of measures to reduce non-deductible VAT for the financial sector. 257
13.1 Policy consideration 2A – Review of VAT grouping and CSAs 257
13.2 Policy consideration 2B: Mandatory option to tax for Member States 270
14. Block 3: Revisiting the VAT exemption for financial services and introduction of harmonisation measures in sectoral taxes 282
14.1 Introduction 282
14.2 Policy considerations 3A and 3B: Removal of the exemption and IPTs 285

14.3 Policy Consideration 3C – Policy Consideration 3C – Introduction of an FAT for all financial services, with VAT zero-rating and removal of sectoral taxes 316

14.4 Conclusions 324

15. Overall conclusions 329

15.1 Overview 329

15.2 Policy packages and their impacts and implications 331

ABBREVIATIONS AND ACRONYMS

AI	Artificial Intelligence
AIF	Alternative Investment Fund
AuM	Assets under Management
B2B	Business-to-Business
B2C	Business-to-Consumer
B2G	Business-to-Government
BoP	Balance of Payments
CAGR	Compound Annual Growth Rate
CBD	Consolidated Bank Data
CBR	Consolidated Bank Report
CDD	Capital Duty Directive
CI	Credit Institution
CIT	Corporate Income Tax
CJEU	Court of Justice of the European Union
CMU	Capital Markets Union
COICOP	Classification of Individual Consumption by Purpose
CPA	Classification of Products by Activity
CRA	Canada Revenue Agency
CSA	Cost-Sharing Arrangement – Article 132(1)(f) - Directive 2006/112/EC
DGS	Deposit Guarantee Scheme
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
EEA	European Economic Area
EFAMA	European Fund and Asset Management Association
EIB	European Investment Bank
EIOPA	European Insurance and Occupational Pensions Authority
EPIF	European Payment Institutions Federation
ESG	Environmental, Social and Governance
ESMA	European Securities and Markets Authority
EU	European Union
FAT	Financial Activities Tax
FinTech	Financial Technology
FISIM	Financial Intermediation Services Indirectly Measured
FS	Financial Services
FTE	Full-time equivalent
FTR	Fixed-Input Tax Recovery Rate
FTT	Financial Transaction Tax
GAR	Green Asset Ratio

GDP	Gross Domestic Product
GFCF	Gross Fixed Capital Formation
GST	Goods and Services Tax
GVA	Gross Value Added
GWP	Gross Written Premiums
IAIG	International Active Insurance Groups
IBFD	International Bureau of Fiscal Documentation
IPTs	Insurance Premium Taxes
MS	Member State
NACE	Nomenclature générale des Activités économiques dans les Communautés Européennes (Statistical classification of economic activities in the European Communities)
NIR	Notional Ideal Revenue
ORS	Own Resource Submissions
OTT	Option to Tax
PEM	Partial-Equilibrium Model
RITC	Reduced Input Tax Credits
SBS	Structural Business Statistics
SFDR	Sustainable Finance Disclosure Regulation
SIU	Savings and Investments Union
SME	Small and medium-sized enterprise(s)
SRB	Single Resolution Board
SRF	Single Resolution Fund
SUT	Supply and use Tables
ToR	Terms of Reference
UCITS	Undertakings for Collective Investments in Transferable Securities
VAT	Value-Added Tax
VTTL	VAT Total Tax Liability

ABSTRACT

This study, prepared for the European Commission's Directorate-General for Taxation and Customs Union (DG TAXUD), examines the taxation of the financial sector in the EU, covering banking, insurance and other financial services. It assesses the current tax framework, with a focus on the VAT exemption for financial services and the sectoral taxes applied by Member States, and analyses whether this framework remains fit for purpose. The study combines legal, economic, sectoral, VAT liability and compliance analyses, supported by stakeholder consultation in the EU and relevant third countries and economic modelling, including a novel empirical analysis of tax incidence in the financial sector. Starting from the outdated nature of the VAT exemption, which was originally introduced to deal with the technical difficulty of applying VAT to financial services, the study identifies two main problems with the current situation: tax-driven distortions caused by non-deductible (i.e., hidden) VAT on financial services inputs, and an uncertain, complex and fragmented tax framework. These problems increase compliance costs, affect business organisation and outsourcing decisions, and may hinder innovation, specialisation, competitiveness and Single Market integration. The study then assesses possible policy considerations, ranging from targeted modernisation and simplification of the existing VAT rules to broader reforms, including reducing non-deductible VAT, removing the VAT exemption for all or some financial services, and introducing alternative approaches such as a Financial Activities Tax. While noting that any decisions on future action are inherently political, the study finds that it would be practically feasible to remove the VAT exemption, or to improve the tax framework's functioning through more incremental measures, and provides detailed evidence on the impacts, advantages and disadvantages of different approaches.

ZUSAMMENFASSUNG

Diese Studie, die für die Generaldirektion Steuern und Zollunion (GD TAXUD) der Europäischen Kommission erstellt wurde, untersucht die Besteuerung des Finanzsektors in der EU, einschließlich des Bankwesens, des Versicherungswesens und anderer Finanzdienstleistungen. Sie bewertet den derzeitigen steuerlichen Rahmen, unter besonderer Berücksichtigung der Mehrwertsteuerbefreiung, für Finanzdienstleistungen und der von den Mitgliedstaaten erhobenen sektoralen Steuern und analysiert, ob dieser Rahmen weiterhin zweckmäßig ist. Die Studie kombiniert rechtliche, wirtschaftliche, sektorale, mehrwertsteuerrechtliche und Compliance-Analysen, gestützt auf Konsultationen mit Interessengruppen in der EU und relevanten Drittländern sowie auf ökonomische Modellierungen, einschließlich einer neuartigen empirischen Analyse der Steuerlastverteilung im Finanzsektor. Ausgehend vom Alter der Mehrwertsteuerbefreiung, die ursprünglich eingeführt wurde, um die technischen Schwierigkeiten bei der Anwendung der Mehrwertsteuer auf Finanzdienstleistungen zu bewältigen, identifiziert die Studie zwei Hauptprobleme der aktuellen Situation: steuerbedingte Verzerrungen, verursacht durch nicht abzugsfähige (d. h. versteckte) Mehrwertsteuer auf Vorleistungen für Finanzdienstleistungen, sowie einen unsicheren, komplexen und fragmentierten Steuerrahmen. Diese Probleme erhöhen die Compliance-Kosten, beeinflussen die Unternehmensorganisation und Outsourcing-Entscheidungen und können Innovation, Spezialisierung, Wettbewerbsfähigkeit und die Integration des Binnenmarkts behindern. Die Studie bewertet anschließend mögliche politische Überlegungen, die von einer gezielten Modernisierung und Vereinfachung der bestehenden Mehrwertsteuervorschriften bis hin zu umfassenderen Reformen reichen, darunter die Reduzierung der nicht abzugsfähigen Mehrwertsteuer, die Aufhebung der Mehrwertsteuerbefreiung für alle oder bestimmte Finanzdienstleistungen sowie die Einführung alternativer Ansätze wie einer Finanzaktivitätssteuer. Die Studie stellt zwar fest, dass alle Entscheidungen über künftige Maßnahmen naturgemäß politischer Natur sind, kommt jedoch zu dem Schluss, dass es praktisch machbar wäre, die Mehrwertsteuerbefreiung aufzuheben oder die Funktionsweise des Steuerrahmens durch schrittweise Maßnahmen zu verbessern, und liefert detaillierte Belege für die Auswirkungen und Vor- und Nachteile verschiedener Ansätze.

RÉSUMÉ

Cette étude, réalisée pour la Direction générale de la fiscalité et de l'union douanière (DG TAXUD) de la Commission européenne, examine la fiscalité du secteur financier dans l'UE, qui recouvre les services bancaires, d'assurance et autres services financiers. Elle évalue le cadre fiscal actuel, en mettant l'accent sur l'exonération de TVA applicable aux services financiers ainsi que sur les taxes sectorielles appliquées par les États membres. L'étude combine des analyses juridiques, économiques, sectorielles relatives à au traitement TVA et aux obligations de conformité en matière de TVA. Ces analyses sont étayées par une consultation des parties prenantes au sein de l'UE et dans les pays tiers concernés, ainsi que par une modélisation économique, y compris une nouvelle analyse empirique de l'incidence fiscale dans le secteur financier. Partant du caractère obsolète de l'exonération de TVA, initialement introduite pour pallier la difficulté technique d'appliquer la TVA aux services financiers, l'étude identifie deux problèmes principaux dans la situation actuelle : les distorsions fiscales causées par la TVA en amont nondéductible (c'est-à-dire occulte) sur les intrants du secteur financier, et un cadre fiscal incertain, complexe et fragmenté. Ces problèmes augmentent les coûts de mise en conformité, affectent l'organisation des entreprises et les décisions d'externalisation, et peuvent entraver l'innovation, la spécialisation, la compétitivité et l'intégration du marché unique. L'étude évalue ensuite les pistes d'action envisageables, allant d'une modernisation et d'une simplification ciblées des règles de TVA existantes à des réformes plus larges, notamment la réduction de la TVA en amont non déductible, la suppression de l'exonération de TVA pour tout ou partie des services financiers, et l'introduction d'approches alternatives telles qu'une taxe sur les activités financières. Tout en relevant que toute décision concernant les mesures futures est intrinsèquement politique, l'étude conclut qu'il est techniquement possible de supprimer l'exonération de TVA ou d'améliorer le fonctionnement du cadre fiscal par des mesures plus progressives, et fournit des données détaillées sur les impacts, les avantages et les inconvénients des différentes approches.

1. Introduction

This **Final Report presents the results of 'Study on the taxation of the financial sector'**. The study was conducted for the European Commission, Directorate General for Taxation and Customs Union (DG TAXUD)[1], by a group of consulting firms and research institutions led by Syntesia and comprising Intellera, Dale Conseil, Mazars, CASE and SEURECO. It was completed in June 2026.

The **purpose of the study is to provide technical input for the policymaking process**, and as such it takes a very broad perspective. It starts with a comprehensive assessment of the current tax framework of the financial sector, covering both VAT – for which the financial sector is subject to a special exemption – and other sectoral taxes applied at national level in the EU. This leads to an analysis of the problems caused by this tax framework and their consequences, the identification of policy considerations for addressing the problems, and an assessment of the likely impacts were these to be implemented. In addition to findings and conclusions, the report provides background information and detailed technical data in annexes.

This introduction presents the background to the study in terms of its subject, scope, tasks and the wide variety of data-gathering and analytical methods employed. The rest of the report is then structured in three main parts as follows:

- **Part A – Assessment of the current situation (Chapters 2 to 8)** lays the foundation of the study by analysing comprehensively several aspects of the current situation, namely:
  - Analysis of business models in the financial sector and the definition of a typology used to structure the rest of the analysis (Chapter 2);
  - Examination of the VAT framework for the financial sector from a legal perspective, focused on the relevant provisions of the VAT Directive[2] and their implementation and application in the Member States, as well as an overview for comparative purposes of approaches taken by select third countries (Chapter 3);
  - Sectoral analysis of the financial sector in terms of key economic indicators (Chapter 4);
  - Analysis of VAT liability and compliance in the financial sector (Chapter 5);
  - Mapping and analysis of the sectoral taxes applied at national level throughout the EU (Chapter 6);
  - Analysis of the economic impacts of the tax framework, from the perspective of the different implementation choices for the VAT exemption, compliance costs and overall economic impacts on aspects like competitiveness, business behaviour and trade in the EU Single Market (Chapter 7);
  - Examination of taxes and the regulatory framework, which looks at the myriad of prudential regulations applied to the financial sector and their potential interactions with the tax framework (Chapter 8).
- **Part B -Problem analysis, policy objective and considerations** (Chapters 9 to 11) then builds on the previous part to identify and analyse the problems caused by the current situation, their drivers and consequences for stakeholders and society (Chapter 10); policy objectives that would address the problems (Chapter 11); and a series of policy considerations (i.e., potential changes) that could be introduced to achieve the objectives (Chapter 12).
- **Part C – Assessment of the policy considerations (Chapters 12 to 15)**, assesses the impacts of the policy considerations. These are grouped into three 'building blocks' comprising incremental improvements to the VAT exemption (Chapter 12), more significant reforms that would still keep the VAT exemption in place (Chapter 13), and fundamental reforms to both the VAT exemption and

[1] Contract Nr. TAXUD/2024/DE/312.

[2] Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax. ELI: http://data.europa.eu/eli/dir/2006/112/2025-04-14

sectoral tax framework (Chapter 14). Chapter 15 then brings the report to a close with a set of overarching conclusions.

Volume 2 then supplements this main report in the form of several annexes:

- **Annex 1- Stakeholders' consultation synopsis report**, summarises the strategy and results of the extensive targeted consultation exercise conducted for the study;
- **Annex 2 – Analytical methods**, details the technical aspects of several of the economic methods and models used for the study;
- **Annex 3 – Supporting data**, provides additional data collected for the assessment of the current situation, specifically for the sectoral and the VAT analyses;
- **Annex 4 – Sectoral taxes**, provides a detailed breakdown of each sectoral tax identified for the study in terms of aspects like their tax base and rate, and the amount of revenue collected;
- **Annex 5 - Supporting data from the economic models**, providing data derived from the partial equilibrium model and the macro econometric model to support the assessment of potential policy considerations.

1.1 Purpose of the study

The **purpose of the study** is to (i) collect, analyse and present evidence of the existing challenges with the current tax framework for the financial sector (with regard to both VAT and sectoral taxes applied at national level), (ii) provide insight on policy objectives and associated considerations which could address these problems, and (iii) assess and compare the likely impacts of these considerations. In so doing, the study updates and expands on a previous work carried out by the study team, 'Review of the VAT rules for financial services[3], in light of the existing regulatory and other indirect taxation rules' (hereinafter 'the previous study'). The subject matter is defined and described in more detail below.

The **rationale for the study** is rooted in the longstanding and widespread view that the existing tax framework is problematic and poses barriers to the achievement of numerous EU policy objectives. A core aim of the study is to determine whether and to what extent this is the case; this is a complex task that is fully elaborated from different angles in the ensuing chapters. By way of introduction, several elements can be briefly mentioned, which taken together highlight the importance of taking a fresh look at the tax framework for financial services in the EU and assessing its fitness for purpose:

- The EU VAT framework for the financial sector is characterised by exemptions laid down in Article 135(1)(a)-(g) of the VAT Directive, which has been in place since the introduction of the EU VAT system in 1977. This historically stems from the technical difficulty of defining the tax base on services priced in terms of interest-rate spread and other implicit charges. While justifiable at the time, the result is a distortive and complex VAT framework for the sector, as well as reduced sectoral VAT revenue.
- In line with the primarily national competence for taxation, the Member States of the EU take a variety of approaches to taxing the financial sector, including through the application of taxes aimed at offsetting the revenue shortfall from the VAT exemption. This has led to a patchwork of taxes with differing tax bases and liabilities across the EU.
- Digitalisation has profoundly affected business models and supply chains in the financial sector, driving specialisation and enabling providers of financial services to operate internationally rather than primarily in domestic markets. Meanwhile, flagship EU policies such as the Capital Markets

[3] Rohmer B., Luchetta, G., Poli. F., Poniatowski. G. et al, (2021) 'Review of the VAT rules for financial services, in light of the existing regulatory and other indirect taxation rules', submitted to the European Commission in January 2021. Specific Contract TAXUD/2019/DE/313 (unpublished)

Union (CMU)[4] and the Savings and Investment Union (SIU) strategy[5] have made it a priority to remove barriers to integration in the Single Market for financial services, and to mobilise sufficient capital for the EU's most pressing challenges.

The **study is intended to foster a renewed policy debate in the European Commission and among other stakeholders on the taxation of the financial sector**. While it is not a formal impact assessment support study and does not fulfil all the formal requirements of an impact assessment, it adheres closely to the concepts, methods and tools of the Commission's Better Regulation Guidelines and Toolbox[6]. In this way, the study aims to inform future policymaking based on comprehensive, reliable and appropriate evidence, in line with the best practices defined in the Better Regulation framework.

1.2 Subject of the study – the tax framework for the financial sector in the EU

The subject of the study is the tax framework for the financial sector. For this purpose, 'financial sector' encompasses banking, insurance, and other financial services such as asset and fund management[7]. While much of the sector is made up of large firms, particular attention is devoted to small- and medium-sized businesses (SMEs) wherever relevant.

The tax framework under review is comprised of two main components, namely the VAT exemption framework, and other taxes applied to the sector within the EU Member States, each of which is briefly introduced below. Regarding geographical scope, while the primary focus of the study is the EU and its 27 Member States, select third countries are also examined as trading partners and for comparative purposes.

1.2.1 The VAT framework for the financial sector

As mentioned, the VAT framework for the financial sector is characterised by a special exemption system. To understand what this means and what the implications are, a prerequisite is to understand how VAT ordinarily functions.

VAT is a tax levied on the consumption of goods and services within the EU, according to the provisions of the VAT Directive and national implementing legislation[8]. It is a multi-stage tax calculated, and thus charged, on the value added at each stage of the value chain. It is collected from businesses through a system of partial payments. At regular intervals, a **taxable person**[9] pays the VAT due. This is the VAT due on the business' supplies or outputs – the output VAT - after deducting the VAT on its inputs – the input VAT. This system aims to ensure '**neutrality' for business purposes** which is a fundamental principle of VAT and indeed a key strength that has underpinned the adoption of VAT systems worldwide. In practice, VAT neutrality means that different ways of structuring a value chain (in terms of e.g., number of intermediaries in the production process, or in-house versus outsourced production) should have no bearing on VAT liabilities; even though businesses are responsible for collecting and remitting VAT to the tax authority, the ultimate cost of VAT is borne by end consumers. The **integrity of the system depends on the deduction mechanism**, which allows the VAT paid on inputs to be deducted from the VAT due on outputs. As long as all input VAT is deducted, and output VAT charged to customers, the only element that matters from a fiscal perspective is the tax base at the last stage.

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[4] The first CMU action plan was adopted in 2015, and a new one was adopted by the Von der Leyen Commission in 2020, with follow-up plans were adopted in 2021 and 2022.

[5] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: *Savings and Investments Union A Strategy to Foster Citizens' Wealth and Economic Competitiveness in the EU*, COM(2025) 124 final.

[6] Commission Staff Working Document, Better Regulation Guidelines, SWD(2021)305, Brussels, 3.11.2021, complemented by the Better Regulation Toolbox, latest version published December 2025.

[7] In terms of the statistical classification of economic activities used in the EU, the scope of the study encompasses the categories of banking (65), insurance (66) and other financial services (66) and subcategories therein. More information on the classification system can be found on the Eurostat website: Overview - NACE - Eurostat.

[8] As encompassed in Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax and subsequent amendments. Hereinafter, 'VAT Directive' or 'the Directive'.

[9] I.e., any natural or legal person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity. Member States can also collect the tax from other persons in specific cases.

While most supplies of goods and services in the EU are subject to VAT and provide for the deduction of input VAT[10], there are many exceptions to the general rule. Financial services form such an exemption: as per Article 135(1)(a)-(g) of the VAT Directive, **most financial services are *exempt* from VAT**, meaning that they are not taxed, and the providers of these services cannot deduct the VAT incurred on inputs that are used to produce exempt outputs.

This residual input VAT is called 'hidden' VAT, a crucial concept referred to throughout this study. In practice, hidden VAT is borne as a cost for service providers while – since it does not appear on invoices – being invisible to customers. The impacts of this are complex and depend on many factors explored in the study, such as a service provider's customer base, use of in-house vs outsourced inputs, and propensity to absorb or pass on hidden VAT as well approaches to implementing the exemption that vary at national level. But in simple terms, **the exemption breaks VAT neutrality by taxing financial services inputs (the VAT on which cannot be deducted) instead of outputs (for which no VAT is charged)[11]**. This distorts the VAT system not only by taxing inputs, but by taxing inputs differently depending on how a supply chain is organised. For example, for purchased inputs, a supplier would bear input VAT costs equal to the VAT rate, whereas VAT would not be incurred if identical inputs were produced in-house.

Subsequently, since VAT is not charged on financial services outputs, the exemption increases prices for business customers of financial services, since they bear any hidden VAT costs that are passed on, while being unable to deduct input VAT as they would for taxed inputs. In contrast, private consumers and other non-taxable customers (e.g., certain government entities) are not charged output VAT and in principle face lower costs than they would under a normal VAT system.

Several elements further complicate the picture. First, the **status of a service as taxed or exempt** has important implications but may not always be clear in a sector that is highly diverse and quickly evolving, as is the case for financial services. In addition, the VAT Directive provides for a number of **structural provisions**[12] aimed at mitigating the costs and distortions introduced by the non-deductibility of input VAT. Moreover, since a single taxable person can and often does supply services that are taxed, exempt, and 'out-of-scope' (meaning not counted as transactions for VAT purposes), methods are needed to estimate the input VAT that can be deducted, known as the rules for **proportional deduction**. On top of this, the reliance on national implementing legislation creates the risk of divergence at national level. All of these elements are discussed in detail and assessed in the study.

1.2.2 Sectoral taxes applied to the financial sector

Outside the VAT framework, Member States apply a variety of sectoral taxes, including for the purpose of offsetting the fiscal effects of the VAT exemption. In principle, fragmented sectoral taxes can increase complexity for providers of financial services, especially when it comes to cross-border trade, as well as causing fiscal incoherence. The study thus maps and examines sectoral taxes, which are divided into six categories:

1. **Taxes on the sale of certain products**, most importantly insurance premium taxes (IPTs) and certain stamp duties)[13];
2. **Financial transaction taxes** (FTTs);

[10] The EU VAT system includes detailed rules on aspects like the taxable basis for VAT, how to determine place of supply (meaning, the country in which VAT on a given supply is due) and many other aspects. Regarding the VAT rates charged, these vary by country and type of good or service. In broad terms, most goods and services are subject to a 'standard' VAT rate, which is set at national level and cannot be less than 15%. The VAT Directive also provides for a list of goods and services to which Member States may apply lower rates, including 'zero rates', which mean no VAT charged while the VAT incurred on input costs may still be deducted.

[11] For an introduction to the concept of VAT exemptions and their implications, see Chapter 7 (pages 174-176) in Adam, S. et al. (2011). *Tax by design*. Oxford: Oxford University Press, available online at: Tax by design | Institute for Fiscal Studies (last accessed May 2026).

[12] These include VAT grouping and the option to tax, as well as cost-sharing arrangements, though the latter are gradually being removed from use in the financial sector following a 2017 ruling from the Court of Justice of the European Union (CJEU). The structural provisions and proportional deductions rules are fully described in Section 3.1.

[13] Related to this, the study also considers the indirect taxes still levied in certain Member States under the standstill clause of the Capital Duty Directive (Council Directive 2008/7/EC).

3. **Financial institution levies**, which encompass different types of additional taxation measures for financial institutions, such as bank levies that were introduced in the aftermath of the 2007-09 financial crisis;
4. **Payroll taxes**, which are additional taxes on staff salaries[14] in the financial sector;
5. **Additional Corporate Income Tax** (CIT) levied specifically on financial institutions;
6. So-called **windfall taxes**, which target profits occurring due to unforeseen circumstances.

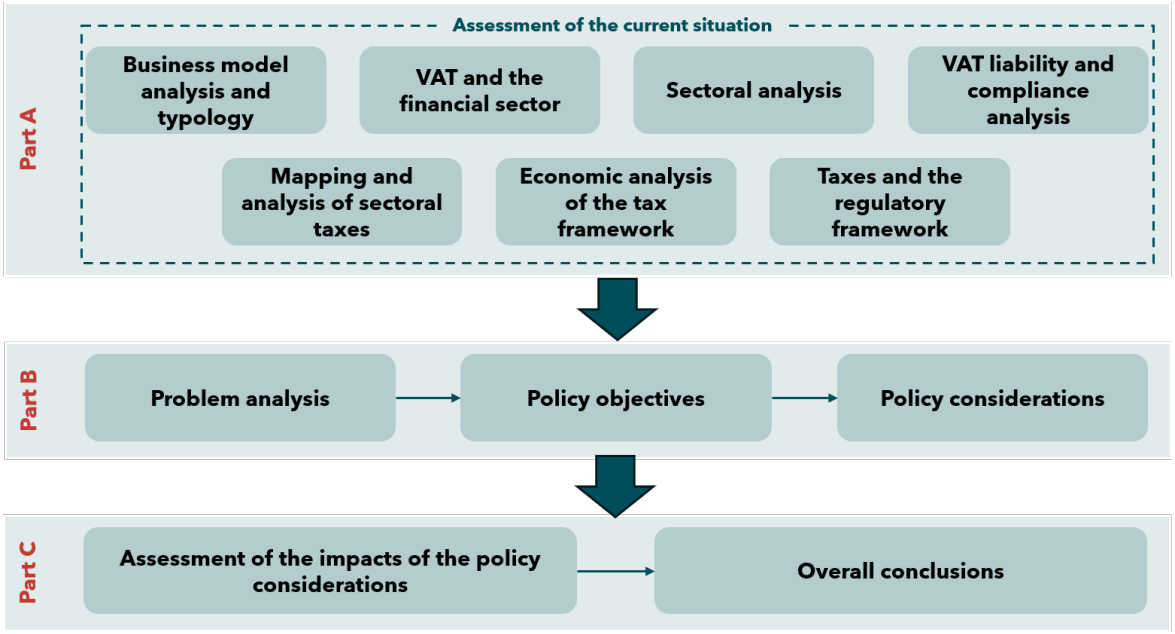
In addition to the sectoral taxes, the study considers the **specific prudential regulatory framework** applied to the financial sector, as well as two EU measures for financial stability and crisis management – the Single Resolution Fund (SRF) and Deposit Guarantee Scheme (DGS). While not taxes as such, these elements can affect the interaction with the tax framework and affect cost structures and business decisions of financial services providers, and thus form a relevant part of the picture.

1.3 Approach and methodology of the study

The study can be conceptualised in terms of **three cumulative and sequential components**. The first component (Part A) is comprised of a comprehensive assessment of the current situation based on several strands of analysis, thereby laying the foundation for the research. The second component (Part B) identifies, elaborates and substantiates the problems caused, and develops objectives and policy considerations (i.e., detailed policy measures) that a potential initiative could address. The third component (Part C) then entails an in-depth assessment of the likely impacts of the policy considerations and draws overall conclusions.

Figure 1 provides a **breakdown of each component in terms of its constituent strands of analysis and indicates where they can be found in the report**. This is followed by an overview of a short description of each component. Since the study relied on a wide range of specialised methods, the detail on these – including with regard to validity and limitations – is presented in the relevant sections and Volume 2 of the report. This section then concludes with a description of the **extensive targeted consultation** that was carried out for the study and used to inform all strands of work, as a vital source of both unpublished quantitative data (e.g., fiscal data from tax authorities, administrative costs for compliance borne by companies) and rich qualitative insight.

Figure 1. Main components of the study



Source: Authors' elaboration.

[14] For example, in France article 231 of the General Tax Code applies the tax using as a tax base salaries and benefits in kind paid to staff.

1.3.1 Part A – Assessment of the current situation

Part A consists of seven distinct strands of analysis that combine to provide a comprehensive assessment of the current situation. As an initial step, the business model analysis and typology (Chapter 2) provide an overview of the types of companies and activities carried out by the financial sector, and defines a typology suitable for the rest of the analysis. Chapter 3 on VAT and the financial sector then lays out the legal provisions of the VAT exemption and their implementation in the EU Member States. For the sake of comparison, it also examines the approaches to taxing the sector of 15 third countries. Chapter 4 then puts the study in perspective by assessing the financial sector in terms of a number of relevant variables in areas including economic importance, employment, turnover, number of companies, cross-border activity, profitability and cost structure and customer base. Chapter 5 considers the VAT perspective, quantifying VAT liabilities and revenues and identifying gaps between theoretical and actual collections, including the extent of non-compliance, fraud and tax evasion, while Chapter 6 maps the sectoral taxes in terms of their type, tax base, revenue and other relevant variables.

The results of these elements culminate in Chapter 7, which provides an economic analysis of the tax framework in terms of compliance costs, business practices (e.g., decisions on whether to outsource, or where to base operations), competitiveness, investment and innovation. This is complemented by Chapter 8 on interactions between the tax and regulatory frameworks, including with regard to SRF and DGS.

Given the breadth of these strands of analysis, the sources of evidence and methods used are also highly diverse. These are described in detail in the corresponding chapters and cited as relevant. In very broad terms, these include (i) desk research from publicly available sources (e.g., Eurostat, the Taxation in Europe Database – TEDB, national statistics, etc.), journal articles and position papers, (ii) a legal mapping carried out by specialists of the study team, (iii) economic models adapted from previous studies for DG TAXUD (e.g., the VAT gap study[15]), (iv) the standard cost model (SCM) typically applied to the assessment of administrative costs, and (v) results of the targeted consultation.

Importantly, **the default reference year for the study is 2023**. This reflects the availability of key datasets, as well as the timing of data collection activities, and ensures that the descriptive activities (e.g., mapping of sectoral taxes) can feed into downstream analytical activities (e.g., economic modelling for Part C) in a consistent and coherent manner. That said, where more recent data was available at the time of writing, this is also referenced for the sake of completeness. In other cases, particularly for certain sectoral parameters not needed for other analytical activities, it was unfeasible to repeat data collection exercises carried out earlier in the study, and figures data from earlier years (usually 2022) are cited. Further explanations on the reference year are provided where relevant throughout Part A of the report.

1.3.2 Part B – Problem analysis, policy objectives and considerations

Chapter 9 provides a synthesis of the assessment of the current situation in the form of an analysis of the problems at stake and their drivers and consequences, and likely evolution under a dynamic baseline in which current policies remain unchanged. This element is provided as a self-standing summary that can be read on its own, separate from the rest of the report. As such, it necessarily repeats information from Chapters 2-8.

Chapters 10 and 11 then elaborate on the policy objectives and considerations that a potential future initiative could address. To frame the assessment, the policy considerations are grouped into three 'building blocks': considerations to modernise and simply the VAT rules (Block 1), considerations to reduce non-deductible VAT for the financial sector (Block 2), and more fundamental reforms to the VAT exemption and sectoral tax framework (Block 3).

[15] European Commission: Directorate-General for Taxation and Customs Union, Bonch-Osmolovskiy, M., Poniatowski, G., Braniff, L., Harrison, G. et al., VAT gap in the EU – 2024 report, Poniatowski, G.(editor), Publications Office of the European Union, 2024, https://data.europa.eu/doi/10.2778/2476549.

1.3.3 Part C – Assessment of the possible policy changes

The last part of the report consists of a comprehensive assessment of the impacts of the policy considerations defined for each building block. This is done based on quantitative economic modelling – using both a sector-specific partial equilibrium model and a macroeconomic model (NEMESIS) to capture wider macroeconomic effects (for descriptions of both models, see Part C introduction) — and mixed method and qualitative approaches where appropriate. This allows for a systematic comparison of all relevant economic, social and environmental impacts in line with Better Regulation principles, and ultimately supports indicative evidence-based conclusions. Since a coherent policy choice could entail a package of policy considerations from across the building blocks, Chapter 15 identifies several such packages and contrasts their likely impacts as a way of bringing the report to a close.

1.3.4 Stakeholder consultation

A targeted consultation exercise was employed as a cross-cutting research activity supporting all analytical tasks of the assignment. It aimed to collect both quantitative and qualitative evidence on the functioning of the current VAT framework for financial services and related sectoral taxes, as well as stakeholders' views on the policy objectives and considerations for the future.

The consultation combined three strands of activities:

- **In-depth interviews in a sample of 12 fieldwork Member States**, targeting tax authorities, other public authorities (e.g., central banks) and businesses, as well as sectoral business federations and VAT experts (specialist practitioners, lawyers, academics). These interviews were held primarily in person;
- **Written contributions in the form of a survey for tax authorities and business federations in the non-fieldwork Member States**;
- **Interviews with EU-level and international stakeholders** targeting:
    - EU federations representing financial services providers, international organisations and institutions, primarily held online though in some cases taking place in person;
    - Third countries experts, including tax authorities, academics and expert practitioners, primarily held online;
    - Interviews with stakeholders from non-fieldwork countries wishing to take part in the study, including business federations, businesses and tax experts.

The **consultation process relied primarily on semi-structured questionnaires** adapted to different stakeholder categories. Separate versions were developed for different types of stakeholders and combined requests for quantitative information (e.g., fiscal data, company micro-data etc.), closed-ended questions and open-ended qualitative questions. These covered a range of themes linked to the objective of the study, including the functioning of the current VAT exemption for financial services, national sectoral taxes, and possible future policy considerations[16]. For interviews conducted at EU and international levels, more tailored questions were developed to facilitate more targeted questioning and thereby enhance the effectiveness and quality of the exchanges.

To grapple with the study's broad scope, technical subject matter and varied, specialist profiles of many stakeholders, the **consultation was conducted in a flexible manner**. Certain stakeholders – particularly tax authorities – were often able to complete the entire questionnaire. For others, the questions were adjusted to focus on a more limited set of issues in line with stakeholders' specific areas of knowledge and interest. Contributions were made via a combination of oral answers given during interviews, written replies to the questions, and email exchanges.

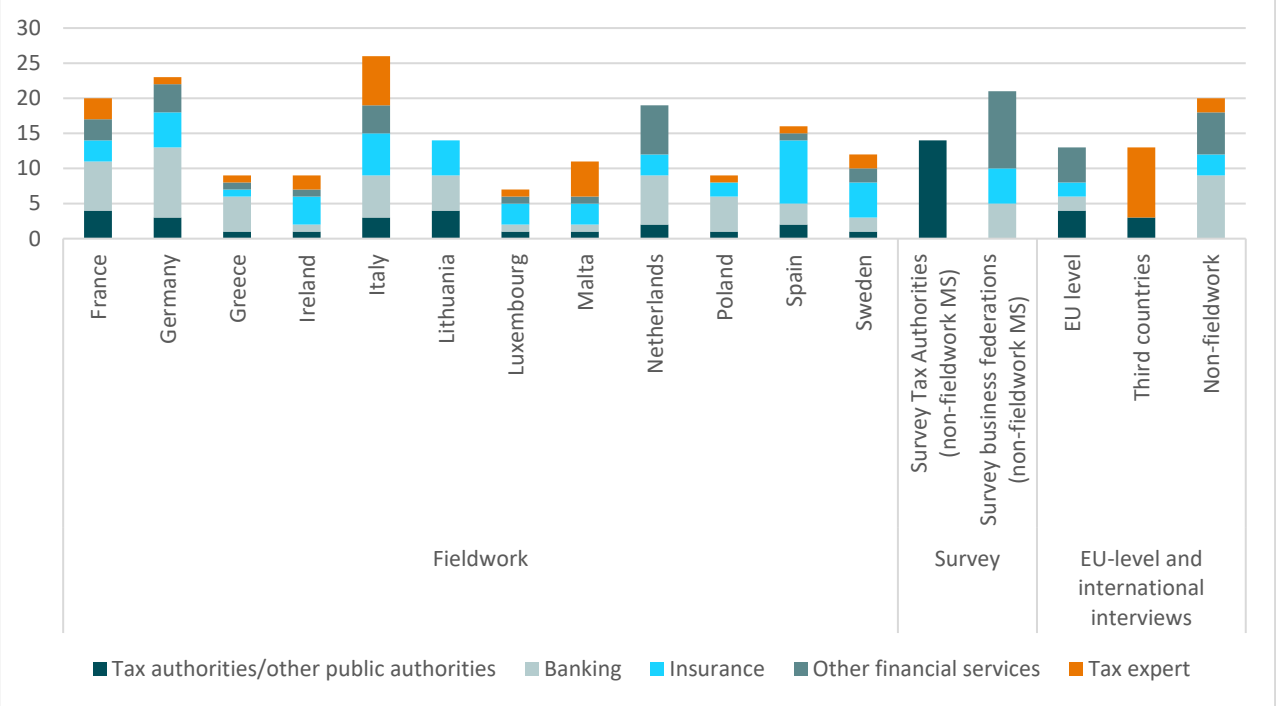
The main wave of interviews took place in late 2024 and early 2025. However, follow-up interviews also continued until the last stage of the study to fill gaps and gather input on developments occurring as the

[16] For an overview of the results of the consultation, see Volume 2 – Annex 1 – Stakeholder consultation synopsis report.

study progressed (e.g., the refined set of policy considerations, which was not yet available when the interviews first took place). Ongoing interactions with EU-level business federations and their members were especially important in this regard. Overall, this approach ensured that the study could gather detailed technical evidence while also capturing practical experiences and broader strategic perspectives from stakeholders.

Figure 2 below provides a **summary breakdown of the stakeholders engaged** for the study, which is further described and elaborated in Volume 2 – Annex 1.

Figure 2. Distribution of stakeholder consultation (per category and country)



Source: Authors' elaboration based on the targeted consultation conducted for the study.

The targeted consultation covered over 250 organisations (circa 290 individual stakeholders) across the EU and internationally, including 175 stakeholders consulted through fieldwork activities in 12 Member States. The broad coverage of stakeholders ensured that the consultation reflected a wide range of perspectives from across the banking, insurance, and other financial services sectors, as well as from public administrations responsible for the implementation and enforcement of VAT and sector-specific taxes.

As mentioned, the targeted consultation was an invaluable source of evidence on issues for which the study could not rely on existing documents and databases alone. This included factual information and quantitative data shared by respondents, such as the fiscal data provided by tax authorities. It also included insight pertaining to the views and experiences of the tax framework from different perspectives. The results of the consultation are thus referred to in various ways throughout the report, depending on the nature of the information in question.

Importantly, the consultation was conducted primarily as a qualitative research exercise aimed at gathering feedback from a wide range of stakeholders. However, it did not seek to obtain statistically representative samples of the stakeholders from different groups. Stakeholders were also granted anonymity in order to encourage candid and open responses. Consequently, **views collected from the consultation is presented in a qualitative manner, without reference to exact numbers or proportions holding a certain view**. It is also worth noting that, while consumer organisations and NGOs were engaged for the study, they were unable to provide substantial feedback due to resource constraints.

Notwithstanding these methodological limitations, **the results of the consultation are considered sufficiently robust for the purposes of this study**. The consultation reached a wide and balanced range

of relevant stakeholders with direct knowledge and practical experience of the tax framework under assessment, thereby ensuring a high level of substantive expertise in the contributions received. Moreover, the consistency of views expressed across stakeholder categories and their alignment with other sources of evidence used in the study provide reassurance as to the reliability of the findings. While not statistically representative, the consultation results therefore offer a sound qualitative basis to inform the analysis and support the findings and conclusions of the report.

PART A – Assessment of the current situation

Part A provides a comprehensive assessment of the current taxation framework applicable to the financial sector through a series of interlinked strands. Taken together, these strands provide an analytical basis for the subsequent problem analysis and assessment of possible future policy considerations.

The business model analysis and typology developed in **Chapter 2** map the main activities and actors in the financial sector and establish a common analytical framework for the study. Importantly, this includes the **grouping of the financial services into the three broad categories of banking, insurance and other financial services (such as fund and asset management)**, which are to structure the ensuing strands of analysis.

The subsequent chapters examine the sector from both tax and economic perspectives.

Chapter 3 analyses the **VAT framework applicable to financial services**, including the legal provisions governing the exemption and their implementation across the Member States, complemented by a comparative overview of approaches adopted in select third countries.

Chapter 4 assesses the **economic significance and structure of the financial sector and its main sub-sectors** (banking, insurance and other financial services), including variables such as value added, employment, turnover, profitability, cost structures, customer base and cross-border activity. It also maps the main actors and business models in the sector, providing the economic and operational context necessary for the subsequent analysis.

The **VAT liability and compliance analysis** in **Chapter 5** examines VAT liability, VAT revenue, the VAT policy gap and the VAT compliance gap, including the effects of exemptions and non-compliance.

Chapter 6 examines the **sectoral taxes applied at national level to financial services and service providers in the EU**, including insurance premium taxes, financial transaction taxes, bank levies, payroll taxes and windfall taxes. It analyses their rationale, scope, fragmentation and revenue significance, highlighting the increasing complexity and diversity of the sectoral tax framework across Member States.

Together, these chapters provide evidence on the structure and performance of the sector, the functioning of the current tax framework, and the interaction between VAT and other sector-specific taxes.

The assessment culminates in **Chapters 7 and 8, which analyse the broader economic and regulatory landscape of the current framework**. Chapter 7 examines the impacts of the tax framework on business practices, compliance costs, competitiveness, investment and innovation, while Chapter 8 considers the interaction between taxation and the wider prudential environment, including the Single Resolution Fund (SRF) and Deposit Guarantee Schemes (DGS).

Given the breadth of the analysis, a wide range of methods and evidence sources are used throughout the assessment of the current situation. These include desk research drawing on publicly available statistical and legal sources, targeted legal mapping carried out by the study team, economic modelling approaches adapted from previous DG TAXUD studies, application of the Standard Cost Model (SCM) for compliance costs, and evidence gathered through stakeholder consultation. The relevant methodological details are presented in the corresponding chapters.

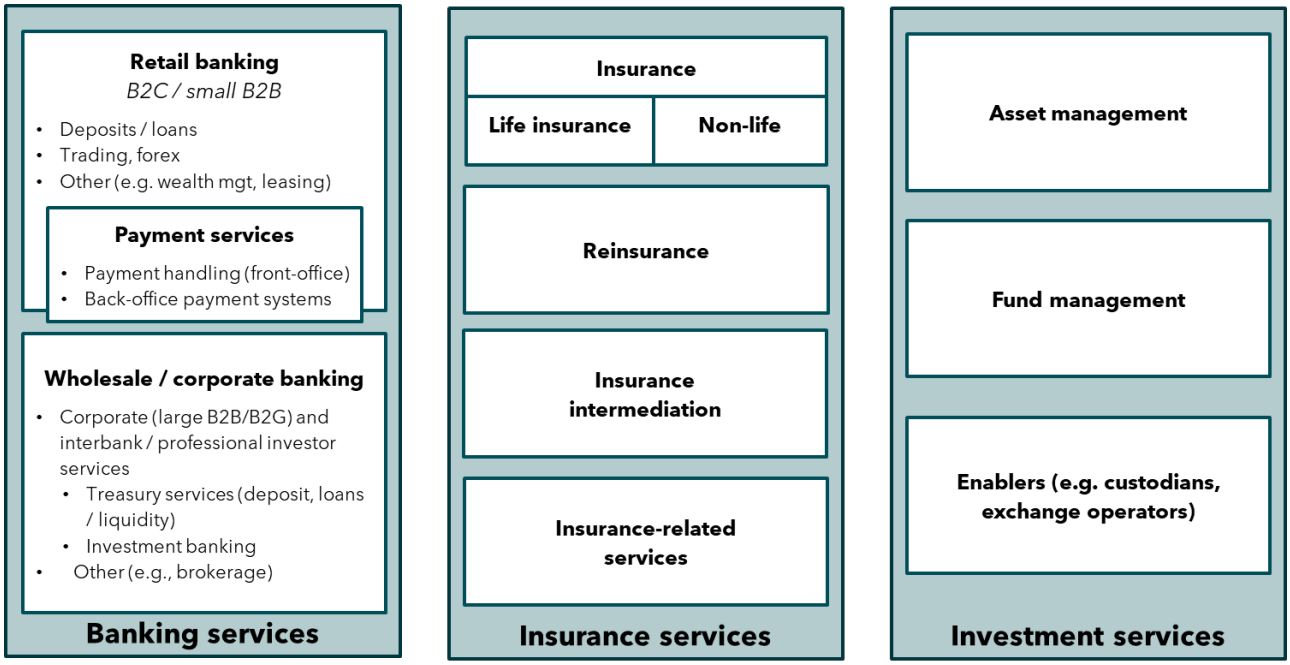
2. Business model analysis and typology

This chapter presents an overview of the business typology used to categorise companies in the financial services sector for the purpose of the analysis. The analysis combines: (i) a business perspective, based on the activities carried out by the various operators; (ii) a legal perspective, matching the activities with the categories of financial services mentioned in the VAT Directive; and (iii) a statistical perspective, matching the activities with the classification used to report fiscal and economic data (NACE codes). This is then complemented by a discussion on the cross-cutting area of fintech. The analysis culminates in Section 2.3, which presents the broad categories of services used to structure the assessment of financial services throughout the rest of the study.

2.1 The typology of activities in the financial sector

Figure 3 below presents the typology of the main business activities within the financial sector. The financial sector value chain is very complex, and firms in this industry provide a vast amount of different but interrelated services, sometimes bundled together, the boundaries of which are often blurred. It is therefore difficult to create a typology that is both neat and comprehensive. With this in mind, the typology provided below lists the major services which are relevant *from the perspective of VAT and other sectoral taxes*, and therefore for the subsequent analysis. Importantly, in the vast majority of cases, suppliers of financial services (e.g., full-service banks) provide several of the services mentioned.

Figure 3. Typologies of financial activities



Source: Authors' elaboration

Banking services include a wide range of different financial supplies to consumers, businesses, other financial institutions, and public entities, concerning money (credit, deposit, payments forex) and investment (trading, wealth management). Most of banking services are exempt from VAT.

Among banking services, a distinction emerges between 'simpler' services provided to consumers and small businesses, and more complex services provided to large corporations, public institutions, and other financial companies. More in detail, **retail banking services** typically include deposits and loans, trading and forex services, wealth management, as well as other more niche areas (e.g. leasing). Within the category of retail banking, banks often lump together households as well as micro and small companies, meaning both B2C and B2B supplies. **Wholesale banking services** include treasury services (deposits, loans, liquidity management, large-scale payment handling) and investment banking (e.g. negotiation in shares, bonds, forex, commodities, and other financial instruments; issuance and negotiation of a company's own

shares, bonds and fixed income instruments; derivative issuance and clearing; merger and acquisitions), in addition to other services (e.g. brokerage for fund managers). Wholesale banking services are comprised almost exclusively of B2B or B2G supplies.

Within banking services, **payment services** have also been included, since historically these have been provided by banks. However, driven by technology, value chains have become longer and more complex, and have allowed niche companies other than banks (payment services providers[17]) to enter the market. In a nutshell, all banks provide payment services, sometimes in cooperation with external service providers; most payment service providers do not provide broader banking services, or only to a narrow extent (e.g. consumer credit linked to the payments handled). Payment services are VAT exempt when they encompass the actual transfer of money[18], but back-office supplies that facilitate the transfer of money (e.g. provision of ATM equipment, provision of data and security checks for payment transactions) are subject to VAT. Indeed, as discussed in Section 3.1.2 the increasing intermediation of value chains is a key driver of uncertainty about whether certain services are or are not covered by the VAT exemption.

As for **insurance activities**, these consist of the supply of 'risk management services' to households and businesses in the form of insurance policies. **Insurance services** provide coverage against a certain risk, in the form of monetary or in-kind compensation when the risk occurs, against remuneration. Insurance services encompass two main segments: (i) life insurance, which, as defined under the Solvency II[19], covers the risk linked to human life (including death and survival), longevity, disability, dependency and certain savings and investment-type products; and (ii) non-life insurance, covering liability, property and health risks among others.[20] Life and non-life insurance services are both exempt from VAT. However, in most Member States, insurance policies are subject to another indirect tax, termed 'Insurance Premium Tax' (IPT), which is levied on insurance premiums and varies by country and type of insurance in terms of the applicable rate. As explained in detail in Section 6.2, IPTs are sometimes introduced to compensate for the VAT exemption, and in a number of countries the applicable rate is in line with the standard VAT rate; however, unlike VAT, there is no right of deduction for business customers. The life insurance segment is more likely to be exempt from or subject to lower IPT rates.[21]

Insurance policies are often distributed via intermediaries. **Insurance intermediation services** include a number of activities which lead to the conclusion of an insurance policy (e.g. identification of clients, conclusion of contracts, and amendment of existing contracts). Insurance intermediation is predominantly carried out by insurance agents or brokers[22]. The importance of banks as insurance distributors is growing (typically, under agency contracts); other companies may also sell insurance policies linked to their main activity (e.g. car hire firms, travel agencies). Insurance intermediation, when carried out by insurance agents or brokers, is exempt from VAT.

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[17] Regulated under Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC (Text with EEA relevance).

[18] More precisely, when they consist of a specific and distinct whole resulting in a variation of the liabilities of the parties involved in the transaction. Cf. Judgment of the Court of 5 June 1997, *Sparekassernes Datacenter (SDC) v Skatteministeriet*, C 2/95, EU:C:1997:278.

[19] Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), ELI: http://data.europa.eu/eli/dir/2009/138/2025-01-17

[20] In some cases, a different segmentation is used: (i) life and health insurance; and (ii) property and casualty, which includes all non-life segments except for health. However, given that health insurance is typically treated as other risk-insurance for VAT purposes, they are grouped together for the typology.

[21] Cf Section 3.2 and section 6.2.

[22] An insurance agent is a person who sells insurance on behalf of an insurance company; it can be either an employee of the company (internal agency), an independent company, or a self-employed agent (external agency); when an agent further delegates the intermediation activities, this is usually termed as 'sub-agency' relation. An insurance broker comes closer to a 'pure' mediator, as it assists the insured party to identify the policy or insurance company most suited to its needs and can also negotiate or conclude the contract of behalf of any parties. The prevalence of agents and brokers in the insurance sector was one of the issues that emerged from the consultation with stakeholders.

Insurance-related services are those instrumental to the main insurance transaction aside from intermediation. These include claims handling, damage assessment, services for the in-kind restoration on claims (e.g. mechanical repair, hiring of a replacement vehicle), collection of insurance premiums, handling and payment of IPTs, customer support, IT management of policies and data, etc. In the past, an insurance company would provide all or most of these services in-house. Today, outsourcing is more and more frequent. Insurance-related services are typically subject to VAT, albeit the definition of what is an insurance service and what is an insurance-*related* service may vary across countries (claims-handling being a typical borderline case).[23]

Finally, **reinsurance services** consist of 'insurance for insurers', serving to further distribute accumulated risks and protect insurers from very large losses. Reinsurance is carried out mostly by specialist reinsurance companies and is exempt from VAT.

The third group of activities consist in **investment services**, and in particular **fund management and asset management**. Fund management consists of the running of collective investment funds for either retail or professional investors. Fund management can be done by specialised fund companies, or by companies that also provide asset management services (including banking institutions). This service is typically VAT exempt, albeit with the scope of exempt funds differing to a certain extent by Member State.[24] Asset management consists of managing investments on behalf of end clients – e.g. consumers, corporations, other financial institutions, fund managers or public institutions. Financial companies, e.g. insurance companies and banks, usually rely on asset managers to manage their own funds or those entrusted to them by their clients. These services can either be provided in-house, usually within large financial conglomerates, or outsourced to specialised companies. Within this segment, **enablers** are also relevant: they do not manage investments or funds *per se,* but carry out a number of instrumental activities, such as security custody, trade execution, running of financial exchanges, clearing houses. The VAT treatment of asset management and enablers differs depending on the specific services and the client (collective fund versus individual portfolio management) as analysed in section 3.1.2 of this report.

2.2 Fintech

Fintech, a shortcut for "Financial Technology", is a broad term that means "technology-enabled innovation in financial services that could result in new business models, applications, processes or products with an associated material effect on the provision of financial services"[25]. Many of the financial services described in the typology can be supplied by fintech companies or via fintech solutions, replacing or complementing traditional channels, a phenomenon that is increasingly common. For this reason, fintech is not defined as a distinct category for the typology, but rather as a means of service delivery. It merits brief discussion here, not least because the business models applied have potential implications for tax treatment, as discussed in Section 3.1 below.

Fintech services can be **front-office, i.e. consumer-facing**, or **back-office, i.e. consisting of systems and technologies used by financial institutions to deliver services to customers** (e.g. supporting tools for payment technologies). The consumer-oriented services came first, via services such as e-banking, e-commerce and digital wallets that made certain basic financial services cheaper and more widely accessible. The focus then shifted to mobile payments, digital lending, insurance, and business finance. More recently, the industry's latest frontier – so-called Fintech 3.0 – includes payment rails[26], open banking

[23] Cf. Section 3.1

[24] Cf. Section 3.1

[25] Financial Stability Board (2019), FinTech and market structure in financial services: Market developments and potential financial stability implications, available at: https://www.fsb.org/2019/02/fintech-and-market-structure-in-financial-services-market-developments-and-potential-financial-stability-implications/ (last accessed March 2026)

[26] Payment rails are the underlying infrastructure and systems that facilitate the transfer of funds between parties.

(meaning services that allow non-bank companies to offer banking services to the customers), and digital currency infrastructure[27].

Fintech companies are usually able to **cut operational costs through the use of technology**, often by automating services that previously required human intervention, eliminating intermediaries, and streamlining processes more efficiently than traditional players. These companies typically aim to make financial services more accessible and usable by non-financial companies, businesses and consumers by means of specialised software and algorithm-driven solutions that can be accessed through computers and smartphones.

According to BCG, **the global fintech sector will reach a market size of $1.5 trillion in revenues in 2030**, up from $320 billion in 2024[28]. Fintech revenues have grown at a rate of around 14% per annum in recent years, even as the general sentiment in the sector has shifted from growth to prudence, with resulting slower growth. Other sources paint a similar picture, pointing to a decline in venture capital investment in the sector, suggesting slower growth as a response to liquidity constraints[29].

In 2023, the European fintech sector market size was estimated at around EUR 75 billion, with an estimated growth up to EUR 351 billion by 2032[30]. The EU fintech sector experienced significant growth in the last decade, as shown by the number of new fintech firms: between 2016 and 2023, the number of fintech companies established was twice the number that was seen in the period 2000-2015. Northern European countries like Sweden, Ireland, the Netherlands, Estonia and Denmark lead the EU market in terms of fintech size, funding and scaling capabilities[31]. This heterogeneity can also be observed within countries, as roughly 53% of all EU fintechs are located in a financial centre, suggesting that the industry's growth is linked to geographical clusters, investment in incubators and closeness to equity funding opportunities[32]. In line with global trends, the European market has experienced a sizeable contraction in investment in recent years, equating to a 25% drop in funding in 2024 compared to 2023 (from EUR 3.8 billion to EUR 2.9 billion, of which 65% is directed to UK fintechs)[33].

Fintechs have **different business models, typically classified in terms of products**. The main categories of fintechs can be described as follows, while bearing in mind that the lines are sometimes blurred and that fintech companies can provide multiple types of services:

- Payment and banking services, i.e. providers of web- or app-based services such as deposits, wire transfers, credit and debit cards, as well as of point-of-sale technologies and remittance services.
- Embedded finance, consisting of the integration of financial services (e.g. payments, loans, insurance services) into non-financial platforms or applications using Application Programming Interfaces (APIs).

[27] Finch Capital (2024), State of European FinTech 2024, available at: https://finchcapital.com/post/state-of-european-fin-tech-2024 (last accessed March 2026).

[28] BCG Global (2024), Global Fintech 2024: Prudence, Profits and Growth, available at: https://www.bcg.com/publications/2024/global-fintech-prudence-profits-and-growth. (accessed March 2026)

[29] «What is fintech (financial technology)? | McKinsey». Available at: https://www.mckinsey.com/featured-insights/mckinsey-explainers/what-is-fintech? (last accessed March 2026).

[30] IMARC Group (2025), Europe Fintech Market Size, Share, Trends and Forecast by Deployment Mode, Technology, Application, End User, and Country, 2026-2034, available at: https://www.imarcgroup.com/europe-fintech-market (accessed March 2025).

[31] McKinsey & Company. (2024). What is fintech? Available at : https://www.mckinsey.com/featured-insights/mckinsey-explainers/what-is-fintech (last accessed March 2026).

[32] Fast, O., Gati Z., Kochanska U.,et al. (2024) Rapid Growth and Strategic Location: Analysing the Rise of FinTechs in the EU. https://www.ecb.europa.eu/press/fie/box/html/ecb.fiebox202406_08.en.html?

[33] Finch Capital (2024), State of European FinTech 2024, available at: https://finchcapital.com/archive/state-of-european-fintech-2024 (last accessed March 2026).

- Robo-advising and stock-trading apps. The former involves the provision of algorithmic recommendations for asset managers; the latter in apps allowing the management of one's own portfolio, usually at lower costs than with traditional intermediaries.
- Artificial Intelligence. Fintech is a major adopter of AI, is used inter alia to automate processes, improve fraud detection, optimise credit risk assessment, enhance accessibility with virtual assistants, and enable algorithmic trading.
- Crowdfunding services allowing entrepreneurs to receive funding (donations, capital, or loans) from a pool of individuals connected via a web-based or mobile app-platform.
- Crypto-asset services, such as custody, exchange of crypto-assets for other crypto-assets or fiat currencies, transmission and execution of orders, and operation of exchange platforms[34].
- Insurtech, or insurance-fintechs. They include providers of analytics technologies for insurance companies, personalised, on-demand insurance products, innovative insurance companies, internet-of-things suppliers (e.g. for data collection, claims prevention and management).
- Enabling services, meaning services related to the financial or insurance markets, provided by horizontal breakthrough technologies, such as (i) artificial intelligence services for predictive analytics, investment research process, assessment of creditworthiness; and (ii) open banking, i.e. suppliers of application programming interfaces allowing non-financial businesses to offer financial services to their clients.
- 'RegTech'. It involves using technology to aid the financial sector in facing regulatory challenges and manage risky effectively. Big data, AI, machine and deep learning are among the technologies that allow RegTech companies to offer dynamic and automated solutions for the financial sector.

2.3 Correspondence between business activities and VAT, statistical classification

The sectoral and the VAT analysis relies mainly on data gathered in NACE categorisation. The three sub-sectors are represented by the divisions **K64 (Banking services), K65 (Insurance services) and K66 (Other financial services, representing investment services),** which are further broken down[35] Table 1 below provides the correspondence between the business typology and NACE divisions and classes. The correspondence is approximate. First and foremost, each company is assigned to only one class, the one for which it has the higher turnover, even when they provide a multiplicity of services. This means that banking conglomerates, providing banking, insurance and investment services, are likely to fall within group 64.19. In addition, investment services can be found partly in 64.3 (fund companies belong to this class), but fund managing companies belong to 66.3. Also, activities auxiliary to insurance activities fall within division 66. However, the three divisions are a good proxy for the three types of activity identified, and this is the maximum granularity at which VAT liability data can be provided by most tax authorities.

Table 1. Correspondence of typology categories and NACE codes

Typology	Relevant NACE codes
1. Banking	K64 Financial service activities, except insurance and pension funding
2. Insurance	K65 Insurance, reinsurance and pension funding, except compulsory social security
3. Other financial services	K66 Activities auxiliary to financial services and insurance activities

[34] Regulation (EU) 2023/1114 of the European Parliament and of the Council of 31 May 2023 on markets in crypto-assets, and amending Regulations (EU) No 1093/2010 and (EU) No 1095/2010 and Directives 2013/36/EU and (EU) 2019/1937.

[35] Eurostat, Businesses in financial and insurance activities sector, available from: Businesses in financial and insurance activities sector - Statistics Explained (last accessed May 2026).

Finally, Table 2 below provides a correspondence between the business activities, the scope of the VAT exemption, and the type of supplier. A more detailed explanation of the application of the current VAT system is included in Section 3.

Table 2. Types of sectors/supplies concerned by the VAT exemptions

VAT exemption Article 135	Activities	Service Providers	Typology
(a) insurance and reinsurance transactions, including related services performed by insurance brokers and insurance agents	Insurance	Insurers and reinsurers	Insurance
	Reinsurance		Reinsurance
	Insurance intermediation	Insurance intermediaries	Insurance intermediation
	Insurance supporting activities	Insurers, insurance intermediaries, and other companies	Insurance-related services
(b) the granting and the negotiation of credit and the management of credit by the person granting it	Granting of credit (e.g. consumer, mortgage and corporate credit)	Banks and other financial service providers	Banking services
(c) the negotiation of or any dealings in credit guarantees or any other security for money and the management of credit guarantees by the person who is granting the credit	Negotiation and management of credit and credit guarantees		
(d) transactions, including negotiation, concerning deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments, but excluding debt collection	Deposit accounts	Banks, payment service providers	Banking services
	Current accounts		
(e) transactions, including negotiation, concerning currency, bank notes and coins used as legal tender, with the exception of collectors' items, that is to say, gold, silver or other metal coins or bank notes which are not normally used as legal tender or coins of numismatic interest	Payments, currency transactions, cheques and other negotiable instruments	Banks and other financial service providers, payment service providers	
(f) transactions, including negotiation but not management or safekeeping, in shares, interests in companies or associations, debentures and other securities, but excluding documents establishing title to goods, and the rights or securities referred to in Article 15(2)	Transactions in shares, interests in companies or associations, debentures and other securities	Banks and other financial service providers, asset and fund managers	Banking services Other financial services
(g) the management of special investment funds as defined by Member States	Management of collective investment funds	Asset and fund managers	Other financial services

3. VAT and the financial sector

As a preliminary step to assessing the impacts of the EU VAT exemption framework on the financial services sector, this chapter considers the rules and how they are applied across Member States (Section 3.1) and how these compare to the approaches taken by select third countries (Section 3.2).

3.1 Legal analysis of the EU VAT framework

This section provides the **legal analysis of the VAT framework** for the financial sector. It updates the analysis provided in the previous study, highlighting the most significant changes. Its main purpose is to understand the current national frameworks, to assess the functioning of the various existing approaches, and also to assess how these affect the functioning and competitiveness of the financial services sector (which are further discussed and analysed in Chapter 7 below on the economic analysis).

The analysis is based on the following sources: (i) the legal mapping carried out by Forvis Mazars; (ii) the interviews and survey carried out with tax authorities and private stakeholders; and (iii) desk research[36].

The analysis aims to present the law as currently on the Member States' statute books, as well as its practical application and enforcement. The latter is especially relevant for areas in which information on the legal provisions in force is not sufficient to understand the situation on the ground, such as whether Cost-Sharing Arrangements (CSAs) are still used in practice. For other provisions, e.g., the actual usage of the option to tax or the input tax deduction methods employed, data on the legal provisions in force is complemented by practical considerations on the basis of business standard practices.

3.1.1 Overview of the rules at stake

Article 135 (1)(a)-(g) of the VAT Directive lists the following financial services as exempt from VAT:

Insurance and reinsurance transactions, including related services;

a. The granting and negotiation of **credit** and the management thereof by the person granting it;
b. The granting and the negotiation of **credit guarantees** or any other security for money and the management thereof by the person granting it;
c. Transactions and negotiations concerning **deposits and current accounts, payments, transfers, debts, cheques**, and other negotiable instruments (excluding debt collection);
d. Transactions and negotiations of **currency, bank notes and coins** (excluding coins not used as legal tender or of numismatic interest);
e. Transactions and negotiations of **shares, interests in companies or associations, debentures and other securities** (excluding the safekeeping and management thereof, and excluding shares in immovable properties);
f. The management of **collective investment funds**, as defined by Member States.

Other structural provisions of the VAT Directive, which influence administrative and business arrangements as well as overall VAT liability, also contribute to determining the VAT treatment of the supplies made by the financial services sector. The most relevant provisions are:

- **Option to tax**. Article 137(1)(a) allows Member States to let providers of financial services choose to apply VAT to exempt supplies, with varying degrees of flexibility in implementation. In particular, Member States can decide which financial services can be covered by the option, and whether the options should be exercised at entity or transaction level. The option to charge VAT is not available for insurance services. When the option is exercised, providers enjoy the right to deduct the VAT

[36] Cf PricewaterhouseCoopers (2006) Study to Increase the Understanding of the Economic Effects of the VAT Exemption for Financial and Insurance Services, Final Report to the European Commission, November 2006. Hereinafter, 'PWC 2006 Study'; Ernst & Young (2009), Design and impact of the 'option to tax' system for application of VAT to financial services, Report prepared for the European Banking Federation, October 2009.; Annacondia, F. (2022). EU VAT Compass 2022/2023. IBFD Publications USA, Incorporated; IBFD, VAT Survey Financial Services, European Communities, December 2006; Terra, B., & Kajus, J. (2023). A guide to the European VAT directives.

incurred on the relevant inputs. By 2025, nine Member States[37] had adopted this option, the last one being Poland as of 2022. In five Member States, the option covers all or most financial services (not counting insurance, as mentioned), while in four it applies to specific services only. Generally, the option is applied at the entity level and covers all transactions. However, in Austria, Germany, and, since 2022, in France (which previously applied an entity wide option), it can be applied selectively to certain transactions.

- **VAT groups**. Article 11 of the VAT Directive permits Member States to treat a group of 'legally independent' persons 'closely bound to one another by financial, economic, and organisational links as a single taxable entity for VAT purposes, i.e., as a 'VAT grouping schemes' or, in short, 'VAT groups'. This is beneficial for suppliers of financial services, as it eliminates VAT on intra-group transactions, which become out-of-scope of VAT, similarly to intra-company transactions. VAT groups are currently available in 22 Member States[38].
- **Cost-Sharing Arrangements (CSAs)** are provided by Article 132(1)(f) of the VAT Directive: providers of VAT-exempt supplies can jointly establish and become members of an independent group, which can provide VAT-exempt services to its members, thus reducing the amount of irrecoverable input VAT. In 2017, however, the DNB BANKA[39] and Aviva[40] judgments stated that Article 132(1)(f) of the VAT Directive is not applicable, inter alia to the financial service industry[41]. This judgment has still not been fully complied with, and a number of Member States still allow CSAs for use by this sector.
- **Proportional deduction**. Input VAT cannot be deducted when the input is used for producing supplies that are exempt or out-of-scope of VAT[42]. On that basis, financial service providers can only deduct VAT on inputs used for supplies that are taxed or 'zero-rated'[43] (that are, for example, 'exports' of financial services to non-EU customers)[44] and, partially, on 'mixed inputs' used for both taxed and exempt supplies. The methods for calculating the proportional deduction are described in Articles 173-175 of the VAT Directive. Calculating deductible VAT can be complex and it is usually done under two methods: direct (or actual) use and pro rata (or a mixture of both). The methods for calculation vary between Member States.

Figure 4 and Table 3 below provide a comprehensive overview of the most relevant aspects of the provisions considered across the EU, in particular:

- Whether an option to tax is in place, its scope (broad vs. narrow) and transaction-by-transaction nature;
- Whether VAT groups are available and if they are mandatory);
- Whether CSAs can still be used (as determined by evidence of their usage by the sector);

[37] Austria, Belgium, Bulgaria, Croatia, Estonia, France, Germany, Lithuania, Poland.

[38] Austria, Belgium, Cyprus, Czechia, Germany, Denmark, Estonia, Spain, Finland, France, Hungary, Ireland, Italy, Luxembourg, Latvia, Malta, the Netherlands, Poland, Portugal, Sweden and Slovakia. VAT groups were only recently introduced in Slovenia, in January 2026.

[39] Judgment of the Court of 21 September 2017, *'DNB Banka' AS v Valsts ienemumu dienests*, OJ C 392, 20.11.2017, Case C-326/15, p. 5–5.

[40] Judgment of the Court of 21 September 2017, *Minister Finansów v Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie*, Case C-605/15, ECLI:EU:C:2017:718

[41] The CSA exemption is only applicable to taxable persons or independent groups of persons whose members carry on an activity in the public interest. Therefore, the services supplied by a group whose members carry on an economic activity in the area of financial services, which does not constitute such an activity in the public interest, are not entitled to apply that exemption.

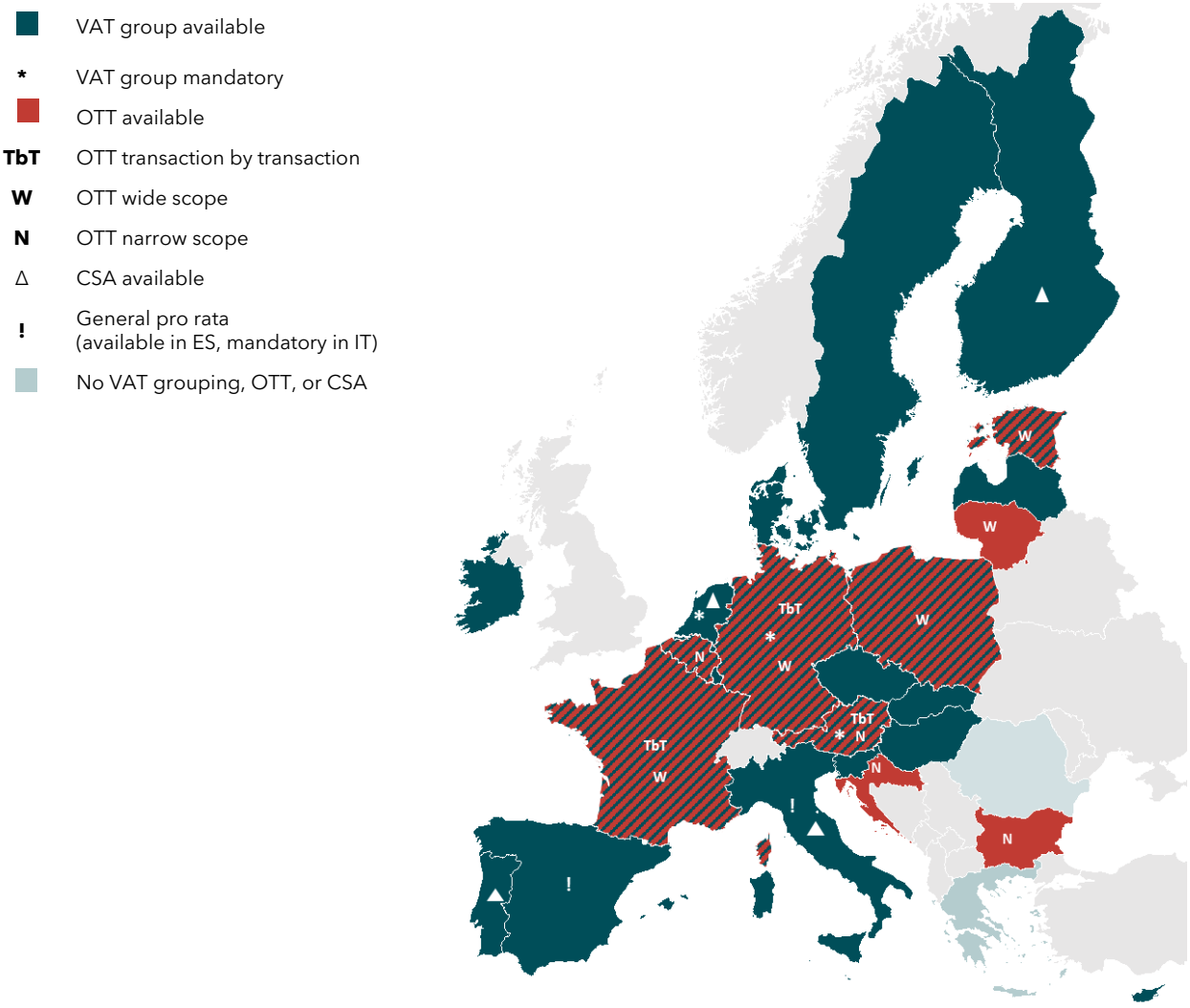
[42] Article 168 of the VAT Directive.

[43] Meaning output supplies that are not taxed but remain in the scope of VAT and give rise to the right of deduction.

[44] Listed in Article 169 of the VAT Directive.

- Whether the proportional deduction regime is significantly different from the general approach provided in Article 168 and in particular by requiring or providing by default a general pro rata regime.

Figure 4. Overview of structural provisions



Source: Authors' elaboration based on the 2025 legal mapping

Table 3. Detailed overview of structural provisions

	Option to tax			VAT Group		CSA still accepted	Proportional deduction	
Member State	***Available***	***Scope***	***Transaction by transaction***	***Available***	***Mandatory***		***Inputs for taxable transactions***	***Mixed inputs***
AT	✓	Narrow scope	✓	✓	✓	✓	Direct Attribution	Actual Use
BE	✓	Narrow scope	-	✓		✓	Direct Attribution	Pro Rata
BG	✓	Narrow scope	-				Direct Attribution	Pro Rata
CY				✓			Direct Attribution	Pro Rata
CZ				✓			Direct Attribution	Pro Rata
DE	✓	Wide scope	✓	✓	✓		Direct Attribution	Actual Use
DK				✓			Direct Attribution	Pro Rata
EE	✓	Wide scope	-	✓			Direct Attribution	Pro Rata
EL							Direct Attribution	Pro Rata
ES				✓			General Pro Rata*	N/A**
FI				✓		✓	Direct Attribution	Actual Use
FR	✓	Wide scope	✓	✓			Direct Attribution	Pro Rata
HR	✓	Narrow scope	-				Direct Attribution	Pro Rata
HU				✓			Direct Attribution	Pro Rata
IE				✓			Direct Attribution	Liberal
IT				✓		✓	General Pro Rata	N/A
LT	✓	Wide scope	-				Direct Attribution	Pro Rata
LU				✓			Direct Attribution	Pro Rata
LV				✓			Direct Attribution	Pro Rata
MT				✓			Direct Attribution	Liberal
NL				✓	✓	✓	Direct Attribution	Pro Rata
PL	✓	Wide scope	-	✓			Direct Attribution	Pro Rata
PT				✓	✓	✓	Direct Attribution	Pro Rata
RO							Direct Attribution	Actual Use
SE				✓			Direct Attribution	Liberal
SI				***			Direct Attribution	Pro Rata
SK				✓			Direct Attribution	Pro Rata

*Source: Authors' elaboration based on 2025 legal mapping. Notes: * Direct attribution is available, optional; ** If direct attribution is used, for mixed inputs pro rata or sectoral pro rata should be used. ***VAT groups introduced in 2026.*

3.1.2 Definitions of financial services

This sub-section provides an overview on how Member States implement the VAT exemption of financial services included in Article 135(1)(a-g) of the Directive. National definitions are relevant to the analysis, because they determine the exact scope of the exemption: broader definitions mean that more services are considered as financial and thus exempt; narrower definitions imply that more services are not considered as financial and are thus taxable. The analysis of the scope of the exemption required a detailed examination of local laws, guidelines and enforcement practices, and hence relied on the direct interactions with local consultants and stakeholders taking place in the 12 fieldwork Member States.

The analysis focuses on a limited number of financial services whose definition emerged as problematic from the previous study, has been scrutinised by the CJEU or the VAT committee, or has been highlighted as problem cases by stakeholders. These concern:

- **insurance-related services**, namely outsourced insurance services, transfers of insurance and re-insurance contracts;
- **derivatives**;
- **payment services**;
- the **management of investment funds and asset management**;
- **custody services**;
- certain **fintech** services and **cryptocurrencies**.

Before going through each service in turn, it can be said that the analysis showed **a rather uniform, yet imperfect, implementation of the definition of financial services across the EU**. The area of more significant disagreement concern insurance-related services, the definitions of which are applied in ways that result in a more extensive scope of the exemption in certain Member States. Minor differences also concern the scope of the exemption when it comes to the management of investment funds, especially pension funds, and, consequently, the associated asset management activities.

In terms of the effects, stakeholders acknowledge the differences in the scope of the exemption and the fact that they make tax treatment more favourable in some Member States. However, **the differences are hardly ever indicated as a source of major competitive distortions**. The stress is often on legal certainty: when the boundaries on the application of the exemption are uncertain, the main concern is not the additional VAT charged, but rather the risk of sanction and penalties in case of incorrect application. The only significant concern with competition relates to the treatment of services provided by fintechs. However, as discussed below, the different treatment does not depend on the nature of the supplier, but of the services provided: fintechs often provide specialised supporting services which fall outside the scope of Article 135 and thus are taxable under the standard VAT system.

➢ Insurance activities

Insurance and reinsurance services are exempt from VAT; the same applies to related services provided by insurance brokers and agents. When a service is not insurance-related, or it is not supplied by brokers and agents, it should not benefit from the exemption. The wording is stricter than that provided for financial services. Indeed, points (b) to (g) (of Article 135(1)) explicitly exempt intermediary services – e.g. for the negotiation of credit, credit guarantees, payment services, and security transactions – without specifying the nature of the *service provider*. Also, for certain financial services, the exemption explicitly applies to transactions 'concerning' or 'relating to' these services[45].

The question of what constitutes an insurance or insurance-related service and the treatment of insurance-related supplies by companies other than agents has been subject of a number of cases before the CJEU. Typically, these cases concern the possibility to apply the exemption to upstream supplies of insurance

[45] Judgment of the Court of 17 March 2016, *Minister Finansów v Aspiro SA.*, C-40/15, EU:C:2016:172, at § 29.

related services by companies other than agents and brokers. The CJEU has refused the application of the exemption, on the grounds of the wording of the Directive, which for insurance services is stricter than for other financial services[46], and because of the general principle by which VAT exemptions must be interpreted narrowly[47]. More in detail, the CJEU case law can be summarised as follows:

- An insurance service consists of "the insurer undertaking, in return for prior payment of a premium, to provide the insured, in the event of materialisation of the risk covered, with the service [or indemnity] agreed when the contract was concluded"[48].
- Transactions which are related to, or concern, insurance transactions are not exempt, even when they represent an essential part thereof, in contrast with financial services, except when provided by insurance agents and brokers[49] Formal qualification as a broker or agent is not decisive, provided that the supplier performs the functions thereof[50]. This principle is, however, not applied uniformly across the Member States.

In practice, specifying exactly which services are exempt and under which conditions in each Member State can be complex. Generally speaking, the following trends can be identified in the fieldwork Member States:

- **Intermediation services (e.g. conclusion of contracts, issuing / amending / receding policies) is always exempt.** This includes when carried out by insurance brokers or agents, or by other companies. The latter is however a rare occurrence, since, for regulatory reasons, insurance intermediation services and the conclusion of an insurance policy contract can only be carried out by licensed operators[51].
- **Support services other than claims handling are generally taxed**, as they are not considered 'insurance-related services'. The exemption could apply when these services are supplied by an insurance intermediary and are considered ancillary to the provision of insurance or intermediation services, e.g. only to the intermediary's direct customers or without separate payments. The application of the exemption depends on the case at stake and the contractual arrangements. Claims handling by brokers and agents is typically exempt
- **Insurance-related services, including claims handling, carried out by companies other than insurance brokers or agents are usually taxed.** In a few jurisdictions[52], however, the interpretation of the *Aspiro* criteria is less restrictive, resulting in a wider application of the exemption. For instance, in Ireland, claims handling and other back-office support can be exempt when it forms an 'integral part of the insurance contract'.

[46] More in detail, for financial services (listed in letters from b to g), the Directive oftens includes 'management' and 'negotiation' thereof among exempt activities. For insurance services, letter (a) extends the exemption only to insurance-related services performed by insurance agents and brokers.

[47] For an example of the application of this principle, *cf.* Judgment of the Court of 11 December 2008*, Stichting Centraal Begeleidingsorgaan voor de Intercollegiale Toetsing*, C-407/07, EU:C:2008:713, at § 30, and the jurisprudence mentioned therein: "[i]t is, moreover, settled case-law that the terms used to specify the exemptions set out in Article 13 of the Sixth Directive are to be interpreted strictly, since they constitute exceptions to the general principle that VAT is to be levied on all services supplied for consideration by a taxable person".

[48] Judgment of the Court of judgment of 17 March 2016, *Minister Finansów v Aspiro SA*, C-40/15, EU:C:2016:172.

[49] Only in one country – Ireland – the treatment is reportedly more favourable, and certain core IT services are considered as insurance transactions and therefore exempt. Cf. Judgment of the Court of 5 June 1997, *Sparekassernes Datacenter (SDC) v Skatteministeriet*, C-2/95, EU:C:1997:278.

[50] Two conditions related to the activities performed should be met: (i) the service provider has a relationship with both the insurer and the insured party, either directly or via another intermediary; and (ii) the activities must include the essential tasks of brokers and agents, such as finding prospective clients and introducing them to the insurer. Judgment of the Court of 3 April 2008, *Beheer*, C-124/07, EU:C:2008:196.

[51] Cf. Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast)Text with EEA relevance, Article 3(1) of the Insurance Distribution Directive.

[52] E.g. Ireland, Luxembourg, Sweden.

➢ *Treatment of derivatives*

A derivative is a contract whose value is derived from the performance of an underlying security or product, called the "underlying", which can be an asset, a financial index, an interest rate or another financial instrument. Derivatives can be used *inter alia* for protection against variations in the price of the underlying (so-called hedging), or to get exposure to these price variations for investment purposes.

For the purpose of the VAT Directive, the conclusion, is that **the issuance or trading of derivative contracts is considered as the trading of securities, and hence it can be exempt under Article 135(1)(f)**[53]. However, **when the underlying of the derivative is a physical good and the contract includes the option to actually deliver the good, it may be considered as a contract for the deferred sale** of that good, thus not a financial security, and thus subject to the standard VAT treatment.

In the 12 fieldwork Member States, there are very limited discrepancies. When the underlying is a financial security, an interest rate, a currency or another financial contract, the derivatives are exempt from VAT. The same treatment largely applies to derivatives the underlying of which are physical goods which, in practice, are exempt from VAT in ten fieldwork countries, except for Greece and Ireland. In all the other countries, the practical treatment is homogeneous, although the applicable regime may differ: the derivative may be exempt unless it provides for actual delivery of the good; the derivative may be taxable unless the actual delivery of good is not foreseen or does not take place, the derivative is always exempt when traded on regulated markets.

Table 4. VAT Treatment of Financial Derivatives

	Derivatives on financial securities or currencies	Derivatives on physical goods
Exempt	Germany, Spain, France, Italy, Lithuania, Malta, Poland, Sweden, Luxembourg, Greece, Ireland and the Netherlands	**Only when physical delivery is not provided and/or when traded in regulated markets**: Germany, Spain, France, Italy, Lithuania, Malta, Poland, Sweden, Luxembourg and the Netherlands
Not exempt	-	Greece and Ireland

Source: Authors' elaboration based on 2025 legal mapping

➢ *Payment services*

Payment services are covered by the exemption provided in Article 135(1)(d) of the VAT Directive. The CJEU has had to intervene in a number of cases to determine the criteria to distinguish between payment services as such, which are exempt, and other supporting services, which are taxable. The criteria were set out first in the SDC judgment[54] in which the CJEU stated that supporting services can be covered by the exemption, provided that: (i) they form a distinct whole; and (ii) they are specific and essential for the provision of the exempt financial services. What is 'specific and essential' to the execution of the payment services is the transfer of funds and the causation of changes in the legal and financial situation of the parties to the transfer[55].

[53] Article 9 of the VAT Implementing Regulation, explicitly states that the sale of an option, where such a sale is a transaction falling within the scope of Article 135(1)(f) of the VAT Directive, is considered as a supply of services on its own, distinct from the underlying transaction.

[54] Judgment of the Court of 5 June 1997, *Sparekassernes Datacenter (SDC) v Skatteministeriet*, C-2/95, EU:C:1997:278.

[55] This interpretation of the definition was confirmed in subsequent recent judgments, such as Bookit (on credit card data handling), AXA UK and DPAS (on the management of debit plans and direct debits), and Cardpoint (on ATM services). *Cf.* Judgment of the Court of 26 May 2016, *Bookit, Ltd v Commissioners for Her Majesty's Revenue and Customs*, C 607/14, EU:C:2016:355; Judgment of the Court of 28 October 2010, *Commissioners for Her Majesty's Revenue and Customs v. AXA UK plc*, C 175/09, EU:C:2010:646; Judgment of the Court of 25 July 2018, *Commissioners for Her Majesty's Revenue and Customs v DPAS Limited*, C 5/17, EU:C:2018:592; Judgment of the Court of 3 October 2019, *Finanzamt Trier v Cardpoint GmbH*, C 42/18, EU:C:2019:822.

In practice, compared to services such as the management of collective investment funds, **the scope of the exemption on outsourced supporting payment services is very narrow**: only the 'last' element of the value chain (i.e., directly involving the movement of money) benefits from the exemption.

Via the legal mapping, local practitioners were asked to comment on the scope of the exemption for payment services, namely whether it covers only services consisting of the transfer of funds, or also to payment-related services other than the transfer of funds. The situation is rather uniform: **in all fieldwork Member States, the exemption only applies to services consisting of the transfer of funds.**

In addition, it has been verified whether the exemption depends on the nature of the supplier, i.e. whether it applies only or differently to financial institutions (e.g. banks) compared to other companies. The legal mapping confirms that this is not the case, and no distinction on the application of the exemption is made based on the nature of the supplier, in line with the transaction-oriented provisions of the VAT Directive.

That said, several stakeholders raised concerns that the exemption is applied differently depending on whether the payment service is provided by a banking institution or by another entity (e.g. a fintech provider). This reconstruction, however, is not accurate: when the payment service consists of the transfer of funds, it is exempt regardless of the nature of the supplier, as confirmed by the legal mapping. The difference is in the business model: banks typically bundle together supporting services and payment services *stricto sensu*, which are then provided to final customers; the whole bundle is exempt. **Fintechs often specialise in the provision of specific payment supporting services to financial institutions and payment processors (hence, B2B supplies), such as handling and checking of customers' data and supporting IT components, which are taxable (hence, generating no hidden VAT).** This is a consequence of the fact that new payment-related services have emerged that could not have been conceived when the exemption was drafted, and also when the leading case – SDC – was ruled by the CJEU. As a consequence, supporting services produced in-house by banks may be less competitive compared to those produced by specialised fintechs.

- ***Management of investment funds and asset management***

The analysis also covered the scope of the exemption in the area of fund management. The first area of investigation concerned the **types of collective investment funds covered by the exemption**. Article 135(1)(g) of The Directive provides that the exemption should be granted to 'special investment funds' as defined by Member States, thus leaving them a relatively wide discretion. Based on the CJEU jurisprudence, **Member States must grant the exemption to Undertakings for Collective Investment in Transferable Securities (UCITS) funds[56], as well as to those equivalent to UCITS[57]. Member States are however free to extend the definition of special (collective) investment funds to other funds**, provided that these are subject to specific state supervision.

In *Fiscale Eenheid X*, the CJEU stated that the management of UCITS and equivalent funds have to benefit from the exemption. To prove equivalence, the following conditions must be met: (i) the purpose of the fund is to carry out collective investment; (ii) the fund must operate on the principle of risk-spreading; (iii) the return on the investment depends on the performance of the investments, and the investor bears the investment risk (excluding pension funds with defined benefits); (iv) the fund must be subject to state supervision; and (v) the fund must be subject to the same conditions of competition and appeal to the same

[56] UCITS funds are collective funds targeted to the retail public investing in transferable securities or other liquid assets working on the principle of risk spreading and redeemable at will by investors. These funds are subject to a dedicated regulatory framework and can be marketed to final consumers throughout the Single Market. *Cf.* Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

[57] To prove equivalence, the following conditions must be met: (i) the purpose of the fund is to carry out collective investment; (ii) the fund must operate on the principle of risk-spreading; (iii) the return on the investment depends on the performance of the investments, and the investor bears the investment risk (excluding pension funds with defined benefits) ; (iv) the fund must be subject to state supervision; and (v) the fund must be subject to the same conditions of competition and appeal to the same circle of investors as UCITS. *Cf.* Judgment of the Court of 9 December 2015, *Staatssecretaris van Financiën v Fiscale Eenheid X NV cs*, C-595/13, EU:C:2015:801, in particular §§ 32 and 33.

circle of investors as UCITS. For non-UCITS fund, the assessment of equivalence must be done on a case-by-case basis. These principles are reflected in the Guidelines adopted by the VAT Committee, though there was no unanimity on these issues at the time of adoption.[58]

The legal mapping shows that, in line with the jurisprudence and the VAT Committee guidelines, **the management of UCITS funds is exempt** in all 12 fieldwork Member States. **Differences concern other type of funds**:

- **Alternative Investment Funds**[59] (such as private equity funds, hedge funds, real estate funds, venture capital funds) are exempt in nine Member States, partly exempt in two Member States, and not exempt at all in Greece;
- Eight Member States exempt the management of **pension funds** only when they are defined contribution funds[60], in line with the CJEU jurisprudence which exclude the management of direct benefit funds from the scope of the exemption, on the ground that the members of the fund do not bear a financial risk[61]. Four Member States exempt all pension funds: however, in some of these countries, funds with defined benefits have no or negligible presence in the market.
- In a few Member States, the exemption is explicitly extended to **other forms of funds**, such as venture capital funds, European social entrepreneurship funds, European long-term investment funds, and Pan-European Personal Pension products. However, this does not mean that management of such funds is taxable in most Member States; rather, the application of the exemption is determined on a case-by-case basis, verifying the equivalence with UCITS.

Table 5. VAT treatment of management of investment funds

	UCITS	Alternative Investment Funds	Pension funds
Exempt	All fieldwork Member States	Germany, France, Italy, Lithuania, Luxembourg, Malta, Netherlands, Poland, Sweden	Germany, Italy, Malta, Spain
Partly exempt	-	Spain, Ireland	Only defined contribution: Ireland, Lithuania, Luxembourg, Netherlands, Poland, Sweden, France and Greece
Not exempt	-	Greece	-

Source: Authors' elaboration based on 2025 legal mapping

[58] Cf. VAT Committee Working Paper No 936, taxud.c.1(2017)6168695, 9 November 2017, and the ensuing Guidelines resulting from the 109th meeting of 1 December 2017 taxud.c.1(2018)3869725– 949, Document B. Cf. also van Kasterer, E., A Fund Is a Fund or Isn't It? – Some Further Clarification on the VAT Exemption for the Management of Special Investment Funds. Derivatives & Financial Instruments, Vol. 21, No. 2, 2019.

[59] AIFs are non-UCITS collective funds. They include very different types of funds which are in principle reserved to professional investors, but which can, under certain conditions and at Member States' discretion, be sold to retail consumers. Cf. Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 (Text with EEA relevance).

[60] The Netherlands adopted in 2023 the Pensions Future Act, through which the pension system will transitioning, shifting from defined benefit to defined contribution, the overall impact would likely be limited. *Wet toekomst pensioenen*, available at: https://wetten.overheid.nl/BWBR0048328/2026-01-01 (last accessed May 2026).

[61] In a defined contribution pension fund, members of the fund receive a pension linked, partly or wholly, to the amount contributed and a financial return; in a defined benefit pension fund, members of the fund receive a pre-determined amount regardless, in full or in part, of the amount contributed or the financial return. Cf. CJEU judgment of 7 March 2013, *Wheels Common Investment Fund Trustees and Others*, Case C-424/11, CJEU judgment of 13 March 2014, *ATP Pension Service*, C-464/12. Cf. also CJEU judgment of 8 October 2020, *United Biscuits (Pensions Trustees) and United Biscuits Pension Investments*, C-235/19.

In a series of cases, the CJEU has introduced specific rules for asset management services, which form a sub-set of the services included under 'management of investment funds' [62]. The UCITS Directive[63] includes three functions in the activity of collective portfolio management[64]: (i) investment management; (ii) administration; and (iii) marketing[65]. Asset management services, in the VAT domain, broadly correspond to the first function under the UCITS Directive.

To benefit from the exemption, in line with the SDC criteria, asset management services performed by a third party must 'form a distinct whole, and [be] specific to, and essential for, the management of the special investment funds'[66]. Specific and essential services encompass the functions that can be carried out by asset managers according to Annex II of the UCITS Directive (including investment advisory services in certain circumstances[67]), but not mere technical supplies[68].

Importantly, **asset management services can be exempt only when provided to a collective investment fund**. This excludes the management of individual portfolios, both for households and consumers, as well as for corporations and other financial institutions. For instance, the management of investment portfolios held to cover the technical provisions of non-life insurance policies can be considered as individual portfolio management, and thus taxable.

The legal mapping has shown limited variation in the scope of the exemption for asset management services:

- **Asset management is always exempt when provided to a collective investment fund** (in a few countries, provided that the investment fund itself benefits from the exemption);
- **Asset management is exempt in all fieldwork Member States (except for France where it is taxable) when it is provided to an exempt pension fund**; this means that, where defined contribution funds do not benefit from the exemption, neither do the associated asset management services;
- **The situation is more blurred concerning the provision of asset management services to financial intermediaries** (e.g. banks, insurance companies). In this case, the services can be taxable, unless they concern the management of assets on behalf of clients, which are therefore integrated into the 'collective' element (e.g. management of assets underlying life insurance policies in Italy) or are ancillary to the provision of exempt financial services (in Germany). In most countries, when these elements are missing, the services are considered as individual portfolio management, and are thus taxable.

[62] Judgment of the Court of 4 May 2006, *Abbey National plc and Inscape Investment Fund v Commissioners of Customs & Excise.*, C-169/04, EU:C:2006:289, at § 67.

[63] In Annex II of Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

[64] Which, *mutatis mutandis*, come closer to the concept of 'management of investment funds' used in the VAT Directive.

[65] I.e. legal and fund management accounting services; customer inquiries; valuation and pricing (including tax returns); regulatory compliance monitoring; maintenance of unit-holder register; distribution of income; unit issues and redemptions; contract settlements (including certificate dispatch) and record keeping.

[66] Judgment of the Court of 4 May 2006, *Abbey National plc and Inscape Investment Fund v Commissioners of Customs & Excise.*, C-169/04, EU:C:2006:289, at § 67., at § 72. See also CJEU judgment of 2 July 2020, *BlackRock Investment Management (UK) Ltd* (C-231/19), EU:C:2020:513.

[67] Judgment of the Court of 7 March 2013, *GfBk Gesellschaft für Börsenkommunikation mbH v Finanzamt Bayreuth*, C-275/11, EU:C:2013:141.

[68] Such as general administration, depositary functions, or the provision of IT services.

Table 6. VAT Treatment of asset management services

	To collective investment funds	To pension funds	To financial intermediaries
Exempt	All fieldwork Member States	Greece; Spain; Ireland; Italy; Lithuania; Luxembourg; Malta; Poland	Ireland; Greece
Exempt under specific conditions		Netherlands; Sweden	Germany, Italy; Sweden
Not exempt		France	Spain, Lithuania; Luxembourg; Malta; the Netherlands; Poland

Source: Authors' elaboration based on 2025 legal mapping

As for **advisory services,** in line with the VAT Committee Guidelines[69], they are not considered by the Member States to amount to 'negotiation in securities' and thus cannot benefit *per se* from the exemption in Article 135(1)(f) of the VAT Directive. However, they can be considered as ancillary to the negotiation in securities, and thus be exempt when the adviser also acts as an intermediary in the purchase or sale of the securities[70]. This is the situation in all fieldwork Member States, though the stringency of the conditions may vary. This results in a lack of legal certainty on the application of the exemption to such services, as the VAT Committee guidelines are not legally binding.

Certain divergences also exist across Member States regarding the VAT treatment of services provided in the context of Mergers & Acquisitions (M&A) transactions. The core question is whether investment banking services – such as financial advisory, deal structuring and facilitation of share transactions – qualify as "negotiation of securities" within the meaning of Article 135(1)(f) of the VAT Directive, and thus benefit from the VAT exemption. Some Member States have moved towards a **broader interpretation**, treating a wide range of M&A advisory services as exempt where the service provider actively facilitates the transfer of securities and brings the parties together. The Netherlands is a notable example: while its Supreme Court historically required a strict intermediary role, lower courts progressively broadened the scope of the exemption, and a Policy Decree issued in October 2025 now provides explicit guidance recognising that M&A advisors qualify for the exemption even when not strictly performing intermediation activities[71]. Other Member States apply a more **restrictive approach**, limiting the exemption to services that amount to genuine intermediation in the transfer of securities, while treating advisory, due diligence and valuation services as taxable consultancy. Germany and Belgium have generally required that the service provider demonstrably acts as a direct intermediary – a position broadly in line with the CJEU's reasoning in *CSC Financial Services* (C-235/00), which held that exempt negotiation services must alter the legal and financial situation of the parties to the transaction.

On a related service, credit management, the application of the exemption was recently addressed by the Advocate General in case T-184/25[72]. An analysis of the different language versions of Article 135(1)(b) was undertaken to determine whether the management of credit by an undertaking which (i) granted the credit; (ii) subsequently sold the credit; and (iii) continues to manage it after the sale falls within the exemption. The opinion suggests that the wording of the provision varies across Member States, allowing for divergent

[69] VAT Committee Guidelines resulting from the 104th meeting of 4-5 June 2015, taxud.c.1(2015)4694162 – 875, Document B.

[70] Cf. Judgment of the Court of 13 December 2001, *Commissioners of Customs & Excise v CSC Financial Services Ltd.*, C 235/00, EU:C:2001:696.

[71] Cf. *Besluit van de Staatssecretaris van Financiën 10 oktober 2025, nr. 2025-16407, over bemiddeling bij effectentransacties (Besluit bemiddeling bij effectentransacties*.Cf. also www.loyensloeff.com/insights/news--events/news/policy-decree-provides-guidance-for-applying-the-vat-exemption-for-ma-services (last accessed March 2026)

[72] Opinion of Advocate General Brkan delivered on 25 February 2026, Veronsaajien oikeudenvalvontayksikkö Case T-184/25, ECLI:EU:T:2026:141

readings. Some language versions (including Greek, French and Dutch) use the past tense, suggesting the exemption covers only credit management by the original lender, while others (including English, Croatian and Romanian) use the present tense, suggest that the exemption covers credit management by the current holder. Finally, German and Finnish versions seemingly support either reading[73]. Where institutions operate cross-border this creates a risk of inconsistent VAT treatment, potential under- or over-declaration, and exposure to penalties if a national authorities hold a different view.

- ***Custody services***

Custody services are provided by specialised financial institutions – custody banks or global custodians – and consist in the safekeeping (physical or digital) of securities and related services, such as executing sale and purchase transactions, collecting income streams such as dividends and coupons, administering withholding taxes, and providing stockholder information. When supplied to a fund manager, these services often include accounting and the calculation of net asset values, the management of liquidity funds and of sales, and purchases of shares, as well as administration functions. Some of these services are considered exempt, as transactions concerning securities or the management of collective investment funds. However, the CJEU has stated that the exemption does not extend to: (i) the safe custody of the assets by a depositary; and (ii) fund administration.[74]

This area emerged as a discrepancy: in most Member States, fund administration activities are taxed. As a result, custody banks must indicate separately, in their invoices, the fees for this service and impose VAT on it.[75] In other Member States, certain taxed services are considered as ancillary to the main exempt provision and thus benefit from the exemption. Approaches vary across Member States including: applying the exemption only to certain elements, such as transactions in securities under Article 135(1)(f) of the VAT Directive and cash transactions under Article 135(1)(d); always applying VAT to safekeeping and asset servicing services; applying the exemption to safekeeping and asset servicing only where the fund qualifies as a Special Investment Fund under local VAT rules pursuant to Article 135(1)(g); or applying VAT only to a portion of the total custody fee[76].

Differences also exist in the treatment of physical (safekeeping) vs. electronic custody services, and this is also relevant when it comes to crypto custody services. In Germany, both electronic and physical safekeeping are taxed, while other countries consider that only physical custody is outside the scope of the exemption.

Finally, this is one of the two cases (together with certain derivative trading) emerging from the consultation in which VAT is mentioned among the relevant drivers of location. Custody banks are currently concentrated in jurisdictions with more favourable VAT treatments (e.g., Luxembourg), while reducing their presence in other Member States such as Germany and Italy. Multinational financial groups with a captive custody bank are more likely to centralise those services in one of the jurisdictions with a more favourable treatment.

- ***Innovative services: fintech, crypto assets***

Similar to what has been investigated for payment services specifically, the legal mapping surveyed whether the VAT treatment of financial service varies depending on whether they are provided by a 'traditional' licensed financial institution or by a fintech. In all countries for which a reply could be provided,

[73] *Ibidem* Case T-184/25 at § 18.

[74] Judgment of the Court of 4 May 2006, *Abbey National plc and Inscape Investment Fund v Commissioners of Customs & Excise.*, C-169/04, EU:C:2006:289.

[75] To prevent arbitrage across fees, in Italy the tax authority had set a fixed share of the value of the transactions – 28.3% - which had to be considered VATable by custody banks. *Agenzia delle Entrate, Risoluzione 97/E*, 17.12.2013. This approach was discontinued in 2018 because of the changes to the MIFID Directive. Cf. *Agenzia delle Entrate, Risoluzione 26/E*, 6.4.2018.

[76] Rohmer B., Luchetta, G., Poli. F., Poniatowski. G. et al, (2021) 'Review of the VAT rules for financial services, in light of the existing regulatory and other indirect taxation rules', submitted to the European Commission. in January 2021. Specific Contract TAXUD/2019/DE/313 (unpublished); cf also stakeholder consultation Volume 2 – Annex 1.

the answer was negative, meaning that **the nature of the supplier does not impact on the VAT treatment of the supply**. As discussed above for payment services, in practice services provided by fintechs are taxable, but this depends on the fact that they provide services that do not qualify as financial services, but rather are considered as specific support services which do not constitute a 'distinct and essential whole'. When inquired as to whether certain innovative services[77] typically provided by fintechs benefit from a specific VAT treatment, the answer was no: the test is whether the services constitute a financial service within the meaning of the Directive and in line with the CJEU jurisprudence, and hence the VAT treatment is determined on a case-by-case basis; the nature of the supplier is not relevant.

The legal mapping of **VAT treatment of crypto-assets**[78] considered the latest developments at EU level including the CJEU judgment - in particular the implications of Hedqvist[79] and Žaidimų valiuta[80] as well as the Regulation on Market and Crypto-assets (MiCA)[81], the OECD Crypto-Asset Reporting Framework[82]and the associated literature[83]. The MiCA Regulation, adopted in 2023, provides for a wider approach to crypto asset services, not limited to crypto currencies but also encompassing the exchange of crypto-assets for other crypto-assets or fiat currencies, custody, transmission and execution of orders, and operation of exchange platforms.

The treatment of crypto assets in Member States is in continuous evolution and mostly based on general principles and guidance issued by national tax authorities. That said, **the exchange of crypto assets or fiat currencies is broadly recognised as VAT exempt, being equated to transactions in currencies**[84]. Most recently, the VAT Committee unanimously agreed on the VAT treatment of Non-Fungible Tokens (NFTs), as works of crypto art, with any practical use other than that of a means of payment, may not qualify as a currency; hence, the sale of crypto art–where a buyer pays a price in exchange for the artwork, is not covered by the VAT exemption for financial services[85].

Supplies made by crypto exchange platforms, i.e. companies providing services involving the transmission and execution of orders related to crypto assets, can be subject to VAT, depending on the nature of the service and of the asset sold. As previously mentioned, it depends on the function of the asset: if the sole

[77] E.g. crowdfunding, e-payments, point-of-sale apps, automatic advisory services, stock-trading apps, automatic creditworthiness checks, insurtechs, suppliers of IT platforms.

[78] Cf. Guidelines Resulting from the 120th Meeting of 28 March 2022, DOCUMENT B – taxud.c.1(2023)3625373 – 1045; VAT treatment of crypto-assets (Document taxud.c.1(2022)1585400 – Working paper No 1037).

[79] Judgment of the Court of 22 October 2015. *Skatteverket v David Hedqvist*., C-264/14 EU:C:2015:718

[80] Judgment of the Court of 5 March 2026, *MB "Žaidimų valiuta" v Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos*, C-472/24, ECLI identifier: ECLI:EU:C:2026:147.

[81] Regulation (EU) 2023/1114 of the European Parliament and of the Council of 31 May 2023 on markets in crypto-assets, and amending Regulations (EU) No 1093/2010 and (EU) No 1095/2010 and Directives 2013/36/EU and (EU) 2019/1937 (Text with EEA relevance).

[82] OECD (2023), International Standards for Automatic Exchange of Information in Tax Matters: Crypto-Asset Reporting Framework and 2023 update to the Common Reporting Standard, OECD Publishing, Paris, https://doi.org/10.1787/896d79d1-en.

[83] Nykiel-Mateo, A. (2023). The VAT Treatment of Cryptocurrencies. *Kwartalnik Prawa Podatkowego*, (4), 209-226; Kollmann J., (2019) The VAT Treatment of Cryptocurrencies, EC Tax Review, Issue 3, pp. 164-170, https://kluwerlawonline.com/journalarticle/EC+Tax+Review/28.3/ECTA2019019; Ness, S. (2024). VAT/GST harmonisation challenges for digital assets such as bitcoin and NFTs in the EU following Case C-264/14 (Skatteverket v David Hedqist). *International Cybersecurity Law Review*, *5*(3), 459-490; several OECD CTPA/CFA discussion documents; see, e.g., OECD (2023), Global summary of the VAT treatment of crypto assets; OECD (2024), Global summary of the VAT treatment of crypto-assets – Part 2: Connected services; OECD (2024), Analysis of VAT treatment of services connected to the trade in crypto assets; OECD (2025), Case studies to consider the VAT/GST treatment of possible financial crypto-assets.

[84] VAT Committee Guidelines Resulting from the 120th Meeting of 28 March 2022. Cf also VAT Committee Guidelines resulting from the 102nd meeting of 30 March 2015, taxud.c.1(2015)5528628 – 870 (1/2), Document H.

[85] Value Added Tax Committee (Article 398 of Directive 2006/112/EC) Working Paper No 1080, Question Concerning the Application of EU VAT Provisions, *Cf also* VAT Committee (2023), Value Added Tax Committee (Article 398 Of Directive 2006/112/EC) Working Paper No 1060, Question Concerning the Application of EU VAT Provisions,

purpose of the token is to act as a means of payment or a security, the transmission and execution services may benefit from the exemption.

With regard to the treatment of the storage and transfer of crypto currencies, there was an almost unanimous agreement in the VAT Committee that these should be within the scope of VAT and exempt. Therefore, in the case of digital wallets, the providers require the payment of fees for allowing coin users to hold and operate a cryptocurrency and create rights and obligations in relation to the means of payment; such services would be exempt from VAT as payment services. On the other hand, custody services for crypto-assets are often likened to traditional safe-keeping service hence subject to VAT. For instance, according to the legal mapping in Spain, custodian services – such as cold storage platforms – are considered comparable to safe deposit box rentals and are subject to VAT, as they are not deemed financial services[86].

Box 1. Out of scope of VAT vs. VAT-exempt

VAT may not apply to certain supplies of financial services either because the supplies are out of scope of VAT or they are in scope and exempt. More in detail:

- Out of scope. The supply falls entirely outside the VAT system – for instance because there is no payment or transaction for VAT purposes, or the supplier is not acting as a taxable person. No VAT obligations arise whatsoever, and the supplier cannot recover input VAT on costs attributable to the out-of-scope activity.
- Exempt. A supply is made within the VAT system but relieved from output tax under Article 135 of the VAT Directive. No VAT is charged to the customer, and the supplier cannot recover input VAT on costs attributable to the exempt activity. Though in the scope of VAT, most financial services are exempt in this manner.

The CJEU limited the VAT exemption (under Hedqvist, C-264/14) to decentralised cryptocurrencies functioning as alternative means of payment (e.g., Bitcoin). Centralised, game-specific virtual currencies (e.g., in-game tokens, NFTs tied to platforms) are now explicitly excluded from the exemption. These are classified as taxable digital services, not financial transactions or vouchers. The terms of service must distinguish between exempt decentralised cryptocurrencies (e.g., Ethereum) and taxable centralised virtual items (e.g., skins, loot boxes, proprietary tokens). On this matter, the CJEU has also recently ruled in Žaidimų valiuta[87] that in-game currencies do not qualify for the VAT exemption as financial instruments under Article 135(1)(e). This is because in-game currencies lack legal tender status and are confined to a single closed ecosystem. This distinguishes them from cryptocurrencies like bitcoin, which may qualify under the Hedqvist precedent as they function as a broader means of exchange.

While no major issues emerged from the legal mapping, some scholars investigating the VAT treatment of crypto assets argue that crypto currencies have evolved into instruments predominantly used for speculative purposes, which makes the definition of currency unapplicable in those cases. In particular, the treatment of decentralised finance (DeFi) services[88] - e.g., decentralised crypto exchanges, liquidity pool operators, staking intermediation services – creates issues. The main challenge identified is that DeFi transactions are executed through smart contracts based on autonomous protocols, making it uncertain

[86] *Cf* Spanish General Directorate of taxation (2021), Binding tax ruling V2679-21, of November 5, 2021.

[87] Cf Note 80.

[88] Decentralized finance (DeFi) is an emerging peer-to-peer financial system that uses blockchain and cryptocurrencies to allow people, businesses, or other entities to transact directly with each other. https://www.ecb.europa.eu/press/financial-stability - DeFi participants are part of a peer-to-peer network (built on a public blockchain) where assets represented in the network can be transferred automatically (via so-called smart contracts). *Cf* Born, A., Gschossmann, I., Hodbod, A., Lambert, C., & Pellicani, A. (2022). Decentralised finance–a new unregulated non-bank system? European Central Bank.

whether the exemptions for 'negotiation' in financial transactions would apply to fully automated services[89]. The practical implications of subjecting these transactions to VAT are analysed as part of the policy considerations for possible future action in Chapters 11 and 14 below[90].

The creation, verification and validation (mining and forging), supply and modification for own use of crypto currencies are treated mostly in line with the VAT Committee Guidelines[91]. Specifically, the legal mapping shows that, in most Member States, mining is outside the scope of VAT when the recipient of the service is not identifiable, and thus no taxable transaction occurs. However, if miners provide specific services for a fee to identifiable customers – such as transaction verification – those activities would be subject to VAT.

3.1.3 Option to tax

The EU VAT framework (Article 137(1)(a) of the VAT Directive) provides for the possibility for Member States to allow providers of financial services to apply VAT to these, in accordance with rules set at national level. The rationale for this provision is to reduce the distortive effects of the exemption, in particular the hidden VAT weighing on supplies of financial services to (VAT registered) business customers. It can also simplify compliance for taxable persons, which only marginally deal with exempt supplies (e.g. retailers which also provide some form of financing).

Nine Member States make use of the option to tax for the provision of financial services: Austria, Belgium, Bulgaria, Croatia, Estonia, France, Germany, Lithuania, and Poland[92]. In line with Article 137(2), Member States are free to determine the conditions governing the exercise of the option. Among the conditions mapped in this study, the two most relevant ones, in terms of determining VAT liability for supplies made by financial suppliers, are the following:

1. **Scope of the option.** National approaches are very different in terms of the transactions that can be opted in. Two main approaches can be identified: **wide and narrow**. In the first case, the option to tax can be applied to all, most or several financial services, including, in some countries, the provision of credit. In countries which have introduced a narrow option to tax, it is only available for a specific service, such as payment services or consumer credit. These two approaches could have significantly different effects: the wide approach is expected to lead to a significant reduction of hidden VAT across the industry, while the narrow approach only concerns a sub-set of service providers, and its main effect consists of simplifying compliance since, at aggregate level, the effect on the VAT burden is likely to be minor. In particular, exempting the granting of credit in relation to a taxable supply means that ordinary businesses do not need to apply the VAT exemption rules when selling on deferred payment terms. Table 7 below provides an overview of the scope of the option to tax.

Table 7. Option to tax – Scope of application

	Member State	Financial services to which VAT cannot be applied
Wide scope	Estonia	-
	France	Interest income (and services assimilated to interest), credit guarantees, currency exchange

[89] See also Brassfield J., Dawaki H., Mason J., (2025) Impact of decentralized finance on VAT rules, - working paper, at 4. Other interpretative issues analysed by scholars include different technical designs of staking services (staking pool vs. staking as a service) may result in a non-neutral application of VAT exemptions *cf* Cf. Judgment of the Court of 14 July 2011 *Belgian State v Pierre Henfling and Others*. – C-464/10, ECLI:EU:C:2011, para. 38.

[90] For an overview, cf Luchetta G., Bolognini A., Rohmer B. et al. (2026) Study on the challenges of VAT beyond VAT in the Digital Age, on file with the author.

[91] *Ibidem*, mining and forging are (i) out of the scope of the VAT where they are made free of charge; or (ii) taxable, but exempt ex Article 135(e) or (g) of the VAT Directive, when made for a consideration directly linked to the supply.

[92] Based on the 2025 Legal Mapping, as triangulated via secondary sources: Ernst & Young, *Design and impact of the 'option to tax' system for application of VAT to financial services,* Report prepared for the European Banking Federation, October 2009; Annacondia, F., & Herrero Moreno, I. (2023). EU VAT Compass 2023/2024, IBFD.

	Germany	Management of special (collective) investment funds
	Lithuania	Transactions in shares, debentures, and other securities Management of special (collective) investment funds
	Poland	-
Narrow scope	**Member State**	**Financial services to which VAT can be applied**
	Austria	Granting of credit in relation to a taxable supply Credit card transactions
	Belgium	Payment and receipt transactions[93]
	Bulgaria	Granting of credit in the framework of leasing contracts
	Croatia	Granting of credit in relation to a taxable supply

Note: Option to tax is not applicable to the supply of insurance services covered in Article 135(1).

2. **Comprehensive vs. transactional application.** In most Member States, once the financial institution opts for taxation, it must charge VAT on all supplies. But in three Member States – Austria, Germany and France – VAT can be applied on a transaction-by-transaction basis. This has a significant impact on the VAT burden for customers. In 'transactional' Member States, financial institutions will only apply VAT to business customers with the right to deduct, avoiding charging VAT to consumers and taxable persons without the right to deduct, which would increase the VAT inclusive price of financial services for those categories. In 'comprehensive' Member States, all customers of an institution would pay VAT, which would result in higher prices for consumers and taxable persons without the full right to deduct. However, this may be tempered by two considerations: (i) financial groups can concentrate B2B customers in one separate entity, which then opts for VAT; and (ii) only suppliers which mostly cater to the B2B market will exercise the option in the first place.

Compared to the legal mapping exercise carried out in 2019, there have been two significant new changes concerning the option-to-tax regime, namely:

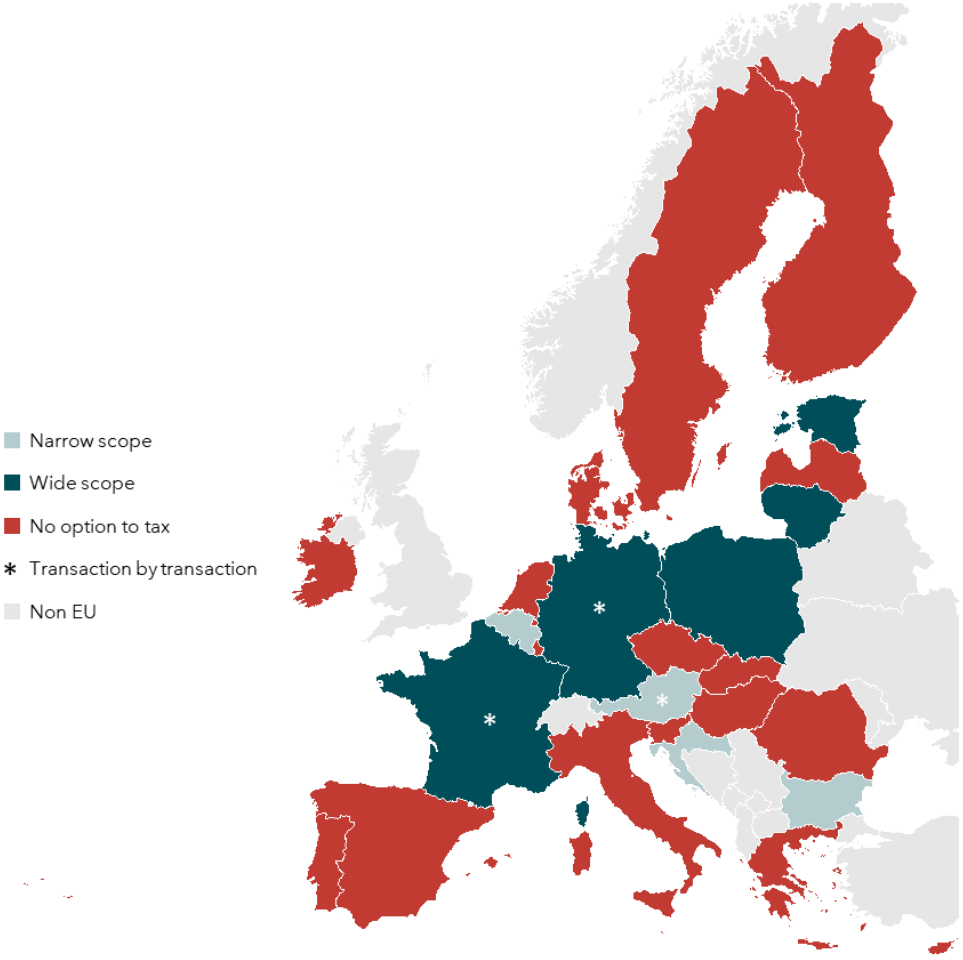
- Poland introduced the option to tax, effective from 2022[94];
- France modified its regime, from comprehensive to transactional, also effective from 2022[95].

[93] According to the Belgian VAT legislation (Loi du 03.07.1969), payment transactions are transactions through which an entity takes care of payments on account of another person; receipt transactions are transactions through which an entity collects payment on account of another person.

[94] VAT Law (USTAWA z dnia 11 marca 2004 r.o podatku od towarów i usług), Art. 43. - [Zwolnienia przedmiotowe] - Podatek od towarów i usług.

[95] Code général des impôts, Article 260B CGI, amended by law n° 2022-1726 du 30 décembre 2022 de finances pour 2023 (1).

Figure 5. Option to Tax for Financial Services



Source: Authors' elaboration based on 2025 legal mapping

Further to the scope and to the transactional nature, other aspects of the option-to-tax are implemented differently across Member States, and namely:

- **Notification** In most Member States (six), except Austria, Bulgaria, and Germany, the option is subject to a notification to the tax authority;
- **Duration**. Once exercised, the option remains applicable for a minimum fixed period of time in France (five years[96]), and in Estonia, Lithuania and Poland (two years). In the other Member States, no minimum period is prescribed for the duration of the option;
- **Taxable basis.** The tax base usually consists of the whole payment received by the financial institution. When credit and loans can be made subject to VAT, the taxable basis corresponds to the interest rate charged by the financial institution to the business customer. The principal is not part of the taxable basis in any of the countries in which the granting of credit can be taxed; similarly, the passive interest paid by banks on deposits cannot be made subject to VAT. The guidance in Germany indeed confirms that the tax base is the consideration received by the financial institution, i.e., either fees or interest paid by the customers. On taxable supplies of credit, there are no specific

[96] As it is transactional the effect can be stopped by not opting

rules to determine which share of the gross interest is 'value added' or not[97, 98]. Stakeholders reported no issues or problems with the determination of the tax basis, including with respect to the granting of credit. In Lithuania, for securities and forex transactions, the tax base is the difference between the resale and purchase price, and any fee received. In Croatia, there is no explicit guidance on the determination of the taxable basis.

The use of the option to tax varies significantly across Member States, influenced by both national regulations and the specific conditions governing its use. According to legal mapping and consultation findings, Germany and Belgium are the countries where this option is more widely utilised, whereas its adoption appears to be moderate in France and Croatia. In many other Member States, either the option is not commonly used or there is limited information available on its implementation[99].

In **Germany**, the option to tax includes the granting of credit and guarantees, payment services, and forex and securities trading, that is most of the typical banking services[100]. Importantly, the option can be exercised on a transaction-by-transaction basis and only when the customer is a business. As a result, banks can differentiate the VAT treatment of supplies in the various market segments (B2B, B2G, and B2C), and, within the B2B segment, impose VAT only on customers which are able to deduct VAT. The imposition of VAT is subject to the bank's verification that the financial service is used for the customer's commercial activity.

Overall, the use of the option in the German banking sector is moderate. It is widely used by cooperative and savings banks for loans, current accounts and payment transactions for their business customers. Private commercial banks, on the other hand, are less likely to make use of this option due to the high initial set-up costs, the challenges associated with implementation and ongoing monitoring costs. More in detail, private banks are more reluctant because of the need to update IT systems and train staff to manage VAT on output transactions, the requirement to prove that the financial service was used for the commercial activity of the client entrepreneur and, in some cases, an unclear legal situation regarding input tax deductions.

From a financial perspective, when asked to quantify the benefit of the option to tax, a federation estimated that larger banks may save approximately EUR 700,000 per year in hidden VAT, while smaller banks typically see savings of around EUR 200,000 per year. Although these savings can be significant, the decision to opt in depends on whether the long-term benefits outweigh the administrative burden and costs associated with handling VAT.

Compared to the previous study two Member States have modified the option to tax regime, Poland and France. In France, the option to tax was introduced in 1978, together with the VAT exemption for financial services. The option covers, in principle, banking transactions, financial transactions, and any transaction in connection with securities trading[101]. However, the law also provides a negative list of operations which cannot benefit from the option to tax, and that has been progressively expanded over the years, such as the issuance of securities and debentures, forex and gold transactions, commissions received from the issuance of shares, and certain credit services[102].

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[97] Umsatzsteuer-Anwendungserlass vom 1. Oktober 2010, BStBl I S. 846 — aktuelle Version (Stand 23. April 2026), Abschnitte 9.1 und 9.2.

[98] Rather, the focus of the guidance is on the application to real estate transactions, especially when the supply needs to be apportioned between an exempt and taxable part (e.g. a building with residential and office spaces). Cf. Umsatzsteuer-Anwendungserlass vom 1. Oktober 2010, BStBl I S. 846 – aktuelle Version (Stand 18. März 2025); at § 9.1 and 9.2.

[99] Detailed insights into the practical use of the option are primarily available for countries where fieldwork was conducted. This is partly because national tax authorities generally do not collect quantitative estimates or qualitative data on its impact on public revenue.

[100] Section 9 Paragraph 1 German VAT Code and UStAE 9.1. Paragraph 5.

[101] Article 260B of the Code Général des impôts.

[102] Article 260C of the Code Général des impôts.

Prior to 2022, the option to tax in France was applied on a comprehensive basis, meaning that financial institutions opting in had to apply VAT to all relevant transactions. Many companies initially opted in, but a significant number revoked their option in 2005 when the French tax authorities allowed them to do so. The option to tax is now applicable on a transaction-by-transaction basis, offering greater flexibility. This change has led to increased take-up, has renewed interest among many financial institutions. While comprehensive data on usage is unavailable, anecdotal evidence from the targeted consultation indicates that many providers of financial services have begun charging VAT on B2B transactions; this allows them both reduce hidden VAT and, more importantly, to no longer have to pay the salaries tax[103].

In Poland, the option to tax was recently introduced and there is little evidence and knowledge on its actual use. Stakeholders consulted have only reported that, probably due to its recent introduction, there are still some doubts across the private sector on the scope of financial services covered by the option and the rules for determining the tax base. Additionally, it was reported that, similar to Germany implementing the option requires substantial initial investments, particularly for the revamping of IT systems, which may prevent a significant uptake.

3.1.4 VAT groups

Article 11 of the VAT Directive allows Member States to treat a group of independent entities which are closely bound to one another by financial, economic and organisational links as a single taxable person. The VAT group may include locally established entities and fixed establishments of foreign entities. Within a VAT group, intra-group transactions are treated as intra-company supplies and thus fall outside the scope of VAT. The compliance with VAT obligations is centralised at group level.

In most EU countries, VAT groups are neither sector-specific nor limited to taxable persons providing exempt supplies. However, they have a specific relevance for the financial services sector, since, for suppliers of exempt services, intra-group VAT would represent a cost. This is especially important given that many suppliers are structured as large corporate groups, with centralised back-office functions, which generate hidden VAT[104].

Currently, **VAT groups are available in 22 Member States**, represented in Figure 6 below. In France, Poland and Portugal these were introduced from 2020 onwards. Slovenia[105] has only recently introduced them starting from January 2026[106].

In most of the implementing Member States, related entities are free to decide whether to establish a VAT group. In three countries, namely Austria, Germany and the Netherlands, VAT groups are mandatory for entities which are bound by financial, economic and organisational links.

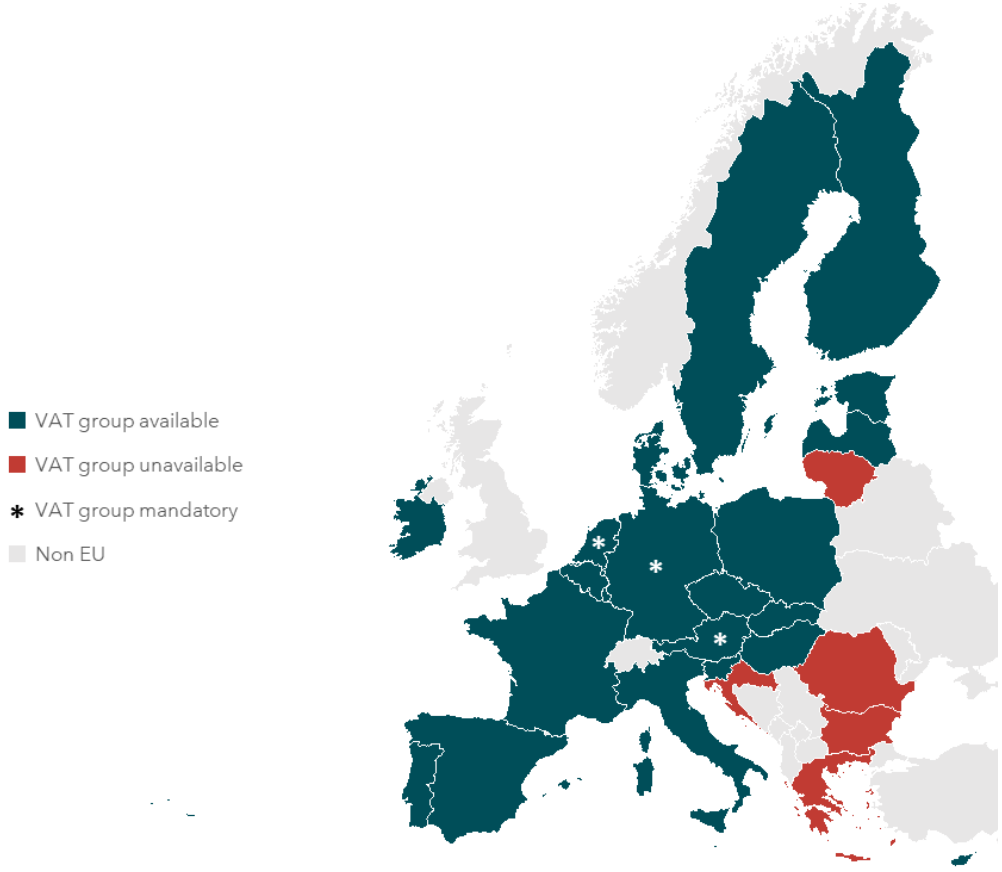
[103] In France, the salary tax (*taxe sur les salaires*) is a levy imposed on employers who are not subject to VAT – or are only partially subject to it – on their total wage bill. Since interest rate-based financial services are generally exempt from VAT, providers of such services become liable for the salary tax on the portion of their activity is not subject to VAT. This creates a significant payroll cost that would otherwise not apply to fully VAT-liable businesses, making the option to tax an attractive tool for those wishing to eliminate this tax burden.

[104] Cf. VAT Expert Group, Paper No 70, 19 March 2018, TAXUD.C.1(2018)1668166; and PricewaterhouseCoopers (2006), Report to the European Commission, Study to Increase the understanding of the Economic Effects of the VAT exemption for Financial and Insurance Services, Final Report.

[105] Working Paper 1083 – Slovenian consultation on VAT group.

[106] VATupdate. (2025). Introduction of the voluntary VAT group system. VAT Update. Available at: https://www.vatupdate.com/2025/04/30/introduction-of-the-voluntary-vat-group-system/ (last accessed July 2025).

Figure 6. Availability of VAT groups



Source: Authors' elaboration based on 2025 legal mapping

The legal mapping also investigated other aspects concerning VAT groups, namely:

- **All-in clause**. In certain countries, VAT groups must include all entities related by financial, economic and organisational links; in other countries, the group can decide to leave certain entities outside of the VAT group.
- **Scope of the activities covered**. In most Member States, there is no limitation to the membership of VAT groups to providers of exempt services. But in three Member States VAT groups are limited specifically to these sectors (Malta, Sweden and Finland)[107].
- **Compliance.** Filing a single VAT return is an obligation in every implementing Member State, except for the Netherlands (in which this is optional) and Spain (in which group members must file their own VAT returns). As for the VAT identification number, in eight Member States the VAT group is assigned a single identification number. In nine countries, separate VAT numbers are maintained for control purposes, while in three countries members of the VAT group must use their own VAT number.

The usage of VAT groups is prominent among providers of financial services. Based on consultation data, **the vast majority of large financial service providers have opted to establish a VAT group**. A few exceptions could be identified, namely:

[107] In Finland, VAT groups are available to enterprises mainly involved in exempt financial and insurance transactions; the group can also control entities carrying out other activities. In Malta, at least one member of the independent group must be from the insurance, financial, or betting sectors. In Sweden, VAT groups are available to (i) companies under the supervision of the financial sectoral regulator; (ii) their suppliers, and (iii) companies acting as commissionaires in any industry. Cf. Annacondia, F., & Herrero Moreno, I. (2023). EU VAT Compass 2023/2024.

- **Cooperative banks**, when their legal structure does not allow them to meet the requirements for being part of a VAT group. In certain cases, cooperative banks have a group structure, with a holding company and a number of local banks; in this case, most of the entities can be included in the VAT group, with the exception of certain service providers[108]. However, in other cases, cooperative banks are independent entities, which are part of an Institutional Protection Scheme and share centralised functions. When this is the case (e.g., in Austria), cooperative banks do not have access to VAT groups. This problem could be addressed by assimilating entities belonging to the same Institutional Protection Scheme to a company group, as it can be done for instance in the case of capital requirements.[109] Indeed, in France, a presumption of financial links for mutual banks and insurance groups has been introduced, even when there is no ownership or control relation[110].
- **Multinational groups without a single country-base**. Most large providers of financial services are multinational groups, in that they have (numerous) branches and subsidiaries in other countries. However, in many cases, they still have a 'centre of gravity' in one country, in which they concentrate most of their activities. However, this is not always the case, and a few multinational groups are truly European, meaning that they have multiple bases in various Member States. For such groups, VAT groups – which is limited to entities established in the same Member States – is less beneficial and may even be detrimental, in terms of VAT liability, because of its effect on transactions involving foreign branches. As stated by the CJEU in the cases Skandia[111] and Danske Bank[112], and re-affirmed by the VAT Committee[113], only entities established in a single Member State can be part of VAT groups therein, and transactions between head offices which are part of a VAT group, and foreign branches are within the scope of VAT. In contrast, when the head office is not part of a VAT group, supplies to foreign branches are considered intra-company transactions, and thus outside the scope of VAT. Therefore, for financial institutions which have many large foreign branches, the advantages of the VAT group may be fully or partly undermined by the additional VAT potentially charged (or accounted for under a reverse charge) on such supplies[114].

The significant advantages offered by VAT groups, including the reduction of irrecoverable VAT and the simplification of administrative compliance, are key factors in explaining their widespread adoption. According to stakeholders, VAT groups reduce VAT liabilities and prevent unnecessary tax burdens on internal transactions. From a public authority perspective, tax authorities benefit from a reduction in VAT assessments and audits, as responsibility for the group is held by a single tax office. This centralised approach streamlines tax administration, making VAT compliance more efficient for both businesses and regulators.

Despite its advantages, VAT groups come with some disadvantages. One of the main challenges reported is the complexity and initial cost of implementing a VAT group, e.g., adapting IT systems to manage internal

[108] Cooperative banking groups may have a double nature, consisting of both corporate entities, and other entities which perform associative functions, and which oftentimes do not have financial, economic and organisational ties with the holding.

[109] *Cf* Art 113(7), Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 Text with EEA relevance). An Institutional Protection Scheme is among a group of banks defined as "a contractual or statutory liability arrangement which protects those institutions and in particular ensures their liquidity and solvency to avoid bankruptcy where necessary".

[110] Article 256 C of the French tax code, Direction Générale des Finances Publiques (2023), TVA - Régime de l'assujetti unique - Création de l'assujetti unique - Détermination du périmètre de l'assujetti unique - Liens financiers, BOI-TVA-AU-10-20-10.

[111] Judgment of the Court of 17 September 2014, *Skandia America Corp. (USA), filial Sverige*, C-7/13, EU:C:2014:2225.

[112] Judgment of the Court of 11 March 2021, *Danske Bank A/S, Danmark, Sverige Filial v Skatteverket*, C-812/19, ECLI:EU:C:2021:196.

[113] Guidelines resulting from the 119th meeting of 22 November 2021, DOCUMENT B – TAXUD.c.1(2022)2315070 – 1034.

[114] When groups rely on subsidiaries, VAT grouping generates no additional intra-group VAT, since cross-border supplies to and from subsidiaries are taxable, regardless of whether there is a VAT group or not in either country.

VAT flows. In addition, as discussed above, some multinational banks do not use VAT groups because of the Skandia and Danske Bank judgments, which made supplies between a VAT group and a foreign branch within the scope of VAT and depending on the transaction potentially subject to VAT; in this case, the reduction of domestic hidden VAT because of the VAT group may be outweighed by the additional hidden VAT on transactions with foreign branches.

Another critical aspect mentioned is the determination of the financial, organisational, and economic linkages. In particular, the organisational link has been the topic of recent Court cases and created a degree of legal uncertainty both for businesses and tax administrations[115]. The so called "all-in, principle"[116] applied in some Member States can also be a deterrent for the use of a VAT group, since it is perceived as too rigid. Another aspect that was reported as hindering the adoption of VAT groups is the joint and several liability: all VAT group members share liability for VAT payments due by all of the members of the VAT group, meaning that if one member fails to meet its VAT obligations, the others must cover the shortfall. However, stakeholders had mixed views about this aspect, with certain large groups not considering joint liability as a problem.

3.1.5 Cost-Sharing Arrangements

Article 132(1)(f) of the VAT Directive provides for the VAT exemption for services provided under **Cost-Sharing Arrangements** (CSAs). A CSA is an entity set up by a group of entities for the joint provision of services to the members of the group on a cost-sharing basis. To benefit from the exemption, the CSA must respect the following five conditions[117]:

1. There is an entity – the independent group – which is the service supplier;
2. The members of the independent group must be taxable persons carrying out non-taxed (such as exempt) or non-taxable activities, or must be non-taxable persons;
3. The services supplied must be directly necessary for the non-taxed or non-taxable activities;[118]
4. The consideration for the services supplied must be based on the exact cost that is attributed to each member of the group, without including a profit margin;
5. The exemption is not likely to distort competition.

The CJEU excluded the usage of CSAs by the financial sector in 2017, when it stated that Article 132(1)(f) of the VAT Directive is applicable only to independent groups of persons carrying out an activity in the public interest, i.e., those listed in the same Article 132[119]. Consequently, providers of other exempt activities, such as financial services, are no longer entitled to benefit from the CSA exemption.

From an economic perspective, the main function of CSAs is to allow providers of exempt services to exploit the economies of scale that arise from the centralisation of joint input services without incurring additional irrecoverable VAT. Typical input services that could benefit from such economies of scale would be IT services or general administrative / back-office support.

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[115] Cf. Judgment of the Court of 1 December 2022, Finanzamt Kiel v Norddeutsche Gesellschaft für Diakonie mbH, Case C-141/20 and CJEU judgment of Opinion of Advocate General Medina delivered on 27 January 2022. Finanzamt T v S., Case C-269/20.

[116] I.e. the fact that VAT groups must include all entities related by financial, economic and organisational link.

[117] VAT Committee Working Paper No 883, 30 September 2015, TAXUD.C.1(2015)4500631; and VAT Committee Working Paper No 856, 6 May 2015, taxud.c.1(2015)2162037.

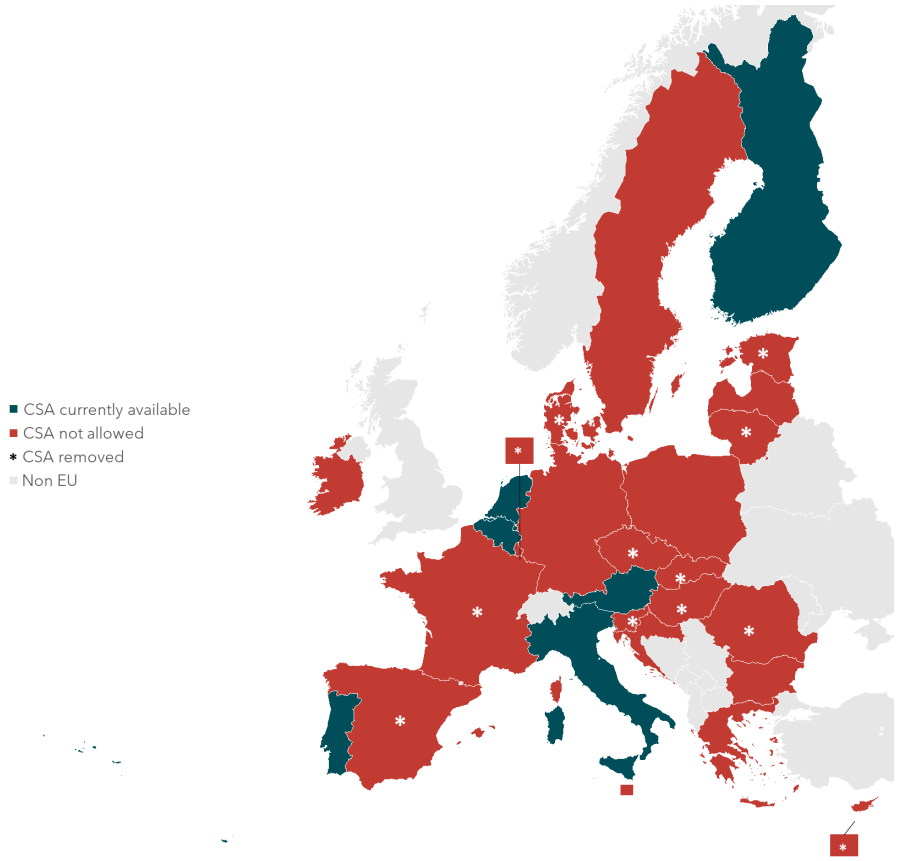
[118] The CJEU clarified that services supplied by the CSA do not need to be indispensable or exclusively linked to the exempt activity to qualify for the exemption; rather it is sufficient that they directly contribute to its exercise. Cf. Joined Cases C-379/24 and C-380/24, Agrupació de Neteja Sanitaria and Others: Judgment of the Court) of 22 January 2026 – *Agrupació de Neteja Sanitària, AIE* (C-379/24), *Educat Serveis Auxiliars SCCL* (C-380/24) *v Tribunal Económico-Administrativo Regional de Cataluña (TEARC).*

[119] Cf. Judgment of the Court of 21 September 2017, *"DNB Banka" AS v Valsts ieņēmumu dienests*, C-326/15, ECLI:EU:C:2017:719.; Judgment of the Court of 21 September 2017, *European Commission v Luxembourg*, C-605/15, ECLI:EU:C:2017:718.; Judgment of the Court of 21 September 2017, *Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie v Minister Finansów*, C-605/15, ECLI:EU:C:2017:718; Judgment of the Court of 21 September 2017, *Finanzamt Hannover-Nord v Medical Leasing GmbH*, C-404/16, ECLI:EU:C:2017:719.

While, in principle, CSAs could be thought to benefit small independent players which, via centralisation, can achieve economies of scale, **their main use in the financial industry is to supply common services within large groups**. Hence, their role largely overlaps with that of VAT groups. Indeed, CSAs were more often used in countries which did not allow for VAT groups, and the prohibition of CSAs by the CJEU spurred more countries to introduce VAT groups. However, there is one fundamental difference between the two tools: VAT groups are limited to established entities, while CSAs could supply VAT exempt services also to branches and subsidiaries located in another Member State. This means that, today, there is no tool to avoid hidden VAT on cross-border intra-group supplies[120].

Before the mentioned CJEU judgments (i.e., as of 1 January 2017), CSAs were available for financial service providers in 18 Member States. As of today, the possibility for providers of financial services to use CSAs had been removed in 12 Member States, through amendments to national VAT legislation, circulars or guidelines, or by enforcement practices[121]. This leaves **six Member States in which they are still allowed**[122], either because they have not amended their legislation, or because financial groups which still use them are not being challenged for its continued use.

Figure 7. Availability of CSAs for Financial Services



Source: Authors' elaboration based on 2025 legal mapping

[120] And, for VAT groups, even for supplies from and to foreign branches.

[121] In other words, the enforcement by tax authorities and fiscal courts would conform to the CJEU judgment even lacking an explicit implementing measure. These are often countries in which CSAs were never available in practice or not used by the financial industry. Compared to the previous study, CSAs were also removed from France.

[122] Austria, Belgium, Finland, Italy, the Netherlands and Portugal.

Following the CJEU judgments[123]. many companies have switched from CSAs to VAT groups, especially in countries in which the latter were recently introduced[124]. Nevertheless, in some Member States, e.g. Italy and the Netherlands, CSAs are still in place, either because VAT groups are not considered sufficient to address the issue of hidden VAT, in particular when the entities involved do not have the necessary economic/organisational control links (e.g. independent entities as in the cooperative sectors), or because they are based on legacy arrangements.

3.1.6 Proportional deduction

As a general principle, only the VAT incurred on inputs used for taxed transactions [125] can be deducted. This means that providers of financial services can only deduct a share of the input VAT incurred. More precisely:

- They can deduct the VAT incurred on inputs used for the purpose of taxed transactions, including those when 'zero-rated'[126]. These transactions typically represent a minority of output transactions in the sectors concerned[127].
- They can partly deduct part of the VAT incurred on 'mixed inputs', i.e., those used for the purpose of both exempt and taxed transactions.
- They cannot deduct the VAT incurred on inputs which are used exclusively for the purpose of undertaking exempt transactions, which represent the large majority of the outputs for most financial institutions.

For inputs used for taxed transactions[128], the vast majority (25) of Member States use the direct attribution method. Under direct attribution, taxable persons can deduct in full the input VAT paid on goods or services used for taxed transactions. This follows from the wording of Article 168 of the VAT Directive. While, in principle, the rule is very clear, it can be difficult to prove the link between the inputs and the taxed transactions.

Only two Member States provide in their legal framework for a **general pro rata** system. Under this system, the share of deductible input VAT on all inputs (taxed and exempt) is calculated based on a pro rata, i.e., on the share of taxable transactions over taxable and exempt transactions, in line with the provisions of Articles 174 and 175 of the VAT Directive. This means that the provider of financial services cannot directly deduct the input VAT paid on goods used for taxed transactions, but must apply the pro rata formula to the whole of the VAT on its input costs[129]. These two Member States are:

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[123] *DNB Banka* and *Aviva*, *supra* note 119

[124] Though not the only reason, this was among the considerations for the introduction of VAT groups in Italy and Luxembourg, as well as France.

[125] Or other supplies giving rise to a right to deduct.

[126] Zero-rated transactions consist of supplies of financial and insurance services – excluding the management of collective investment funds – (i) provided to customers established outside the Community; or (ii) related to the exports of goods.

[127] More in details, they are marginal for most insurance companies, limited or very limited for credit institutions, especially those with a domestic focus (though certain widespread services, such as leasing or individual portfolio management are taxed); more common in the asset management sector, where some services are subject to VAT (when not directly linked to investment decisions) and as the exemption is linked to the nature of the investment fund.

[128] More in details, they are marginal for most insurance companies, limited or very limited for credit institutions, especially those with a domestic focus (though certain widespread services, such as leasing or individual portfolio management are taxed); more common the investment and asset management sector, where the exemption is linked to the nature of the investment fund.

[129] This system is considered in line with the VAT Directive based on the wording of the derogation provided in Article 173(2)(d) and the general principle by which Member States can introduce or continue to apply certain simplification measures derogating from the Directive (Recital 59). Cf. CJEU judgment of 14 December 2016, *Mercedes Benz Italia*, C-378/15, EU:C:2016:950.

- **Italy**, in which the general pro rata system is the only available method. Companies and VAT groups can calculate separate pro rata for different activities. The general pro rata system is coupled with the so-called '36-bis' regime, an option for providers of certain exempt services, including financial ones, to forgo any right to deduct in exchange for a number of simplifications to VAT compliance, in particular in the areas of invoicing and annotations in the VAT ledgers. The optional 36-bis regime is used by the vast majority of financial institutions, which tend to separate the parts of the company which carry out taxable activities[130].
- **Spain**, in which the general pro rata system is the default method, but direct attribution can be used by taxable persons. Direct attribution can also be mandated by the tax authority in case the general pro rata results in an excessively favourable treatment (i.e., a deduction rate which is at least 10% higher than under the direct attribution method).

For mixed inputs, pro rata is the most widespread method[131]but there are many variations and nuances across Member States. The VAT Directive provides for different methods:

- **Pro rata**. The proportion of the VAT paid on goods or services used for both taxed and exempt transactions is determined by calculating the ratio of taxed turnover to the sum of taxed and exempt turnover.
- **Sectoral pro rata**. For taxable persons carrying out different economic activities, and especially when part of those activities is subject to VAT, the pro rata can be calculated per each activity or sector of activities.
- **Actual use**. To the extent possible, the inputs used for both taxed or zero-rated and exempt transactions must be attributed to taxed or exempt turnover, based on their use in the production process. VAT on inputs related to taxed turnover can be deducted in full.
- **Special method**. The taxable person is free to determine the most appropriate method to calculate the deductible VAT[132].

Any of these methods can be required (in general or under specific circumstances), allowed by (with or without notification to or authorisation by the tax authority), accepted in practice, residual (when other methods cannot be used satisfactorily) or prohibited.

To categorise the differences in national frameworks, as in the previous study, **three families of proportional deduction rules for mixed inputs** have been identified, based on the prevalent approach:

- **Pro rata**. This is by far the most common approach, being in place in 18 Member States. In these Member States, the pro rata is the only available method, or the default method[133].

[130] For example, insurance and financial groups include real estate entities, which provide commercial taxed real estate supplies.

[131] The VAT Directive provides in Article 173(1) that, for mixed inputs, the share of deductible input tax is to be calculated in line with Articles 174 and 175 of the same Directive, in which the pro rata method is described. In Article 173(2), however, Member States are allowed to derogate from this system based on a number of possible alternatives.

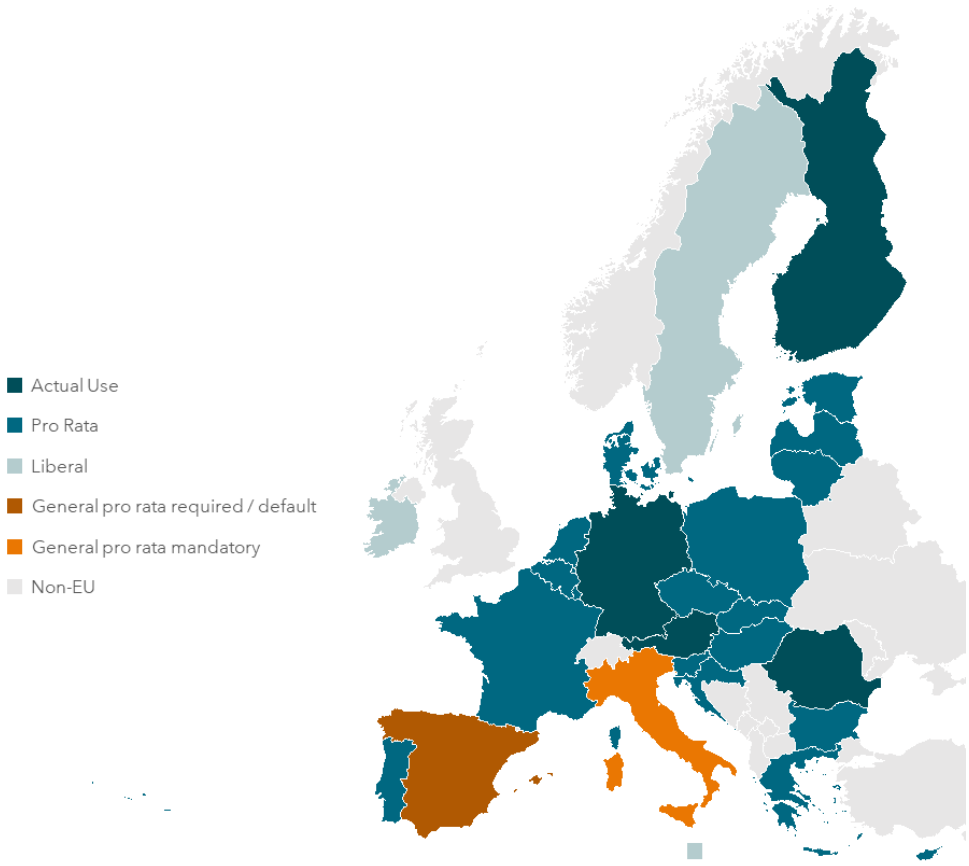
[132] This could include: (i) calculating the pro rata by using variables other than turnover (e.g. office space, number of transactions, amount of labour used for taxed and exempt activities); (ii) adjustment of the pro rata based on other variables (i.e. the joint use of turnover and number of workers variables); or (iii) any other method deemed justified by the taxable person, which may require prior approval of the tax authorities.

[133] Based on the extent to which taxable persons are free to choose other methods, one could further distinguish between (i) stringent pro rata Member States, in which the pro rata (or sectoral pro rata) is, *de iure* or *de facto*, the only accepted method; (ii) normal pro rata Member States, in which taxable persons are free to opt for other methods; and (iii) flexible pro rata Member States, in which other methods can be required in certain circumstances.

- **Actual use**. In four Member States, companies should apply the actual use method to the extent possible, and resort to pro rata only for the residual VAT[134].
- **Liberal**. In three Member States, the taxable person can use any of the standard methods or propose a different one, provided it can be reasonably justified to the tax authority and does not lead to an unfair (i.e. too favourable) deduction rate[135].

In the two remaining Member States (Spain and Italy), general pro rata is applied, either by law or in practice. Importantly, boundaries are sometimes blurred (e.g., in a country a certain method may be available upon authorisation, and the authorisation never be granted; or 'any method' could be used, but in practice this is often challenged in tax audits so that it becomes de facto unavailable to taxpayers). Figure 8 provides a snapshot of the current approaches. Very few changes were reported compared to the previous study[136].

Figure 8. Proportional VAT deduction – national approaches



Source: Authors' elaboration based on 2025 legal mapping

[134] The difference between the actual use and the pro rata approach can be blurred, in practices. Often, even under actual use, use, a large part of the deduction is actually calculated via approximations and pro rata. A proper application of the actual use requires the availability of a tailored IT system and the training of accounting personnel, for the company to be able to justify to the tax authority which inputs are attributable to the taxed turnover.

[135] Sweden had a liberal approach but due to a recent court ruling that determined the legislation incompatible with the VAT directive, a pro rata regime is current in place, pending the introduction of new national legislation.

[136] The most significant change concerns Sweden, which recently adopted the actual use approach. However, the high court ruled that the Swedish regime for proportional deduction was not in line with the VAT Directive, and that the pro rata method should be the general rule, with exceptions. Currently, taxable persons can choose either pro rata or actual use or any of the methods available in Articles 174 and 175 of the VAT Directive, at least until a new legislation on this subject is introduced.

When it comes to the working of the partial deduction methods, in most countries, stakeholders perceived minor to negligible problems, while in a few Member States, more significant problems were reported both by tax authorities and service providers and sectoral federations. In particular, the actual use method is considered more complex to apply than pro rata. Applying the actual use method correctly requires the availability of a tailored IT system and the training of accounting personnel to identify and justify to the tax authority which inputs are attributable to taxed and zero-rated turnover. Classifying an input as 'mixed' is reportedly simpler and reduces the grounds for discussion during audits. Insurance service providers report negligible problems with the proportional deduction, as the vast majority of services provided are exempt from VAT.

Proportional deduction rights become more complex to handle when it comes to inputs borne by foreign branches. Following CJEU's interpretation[137], financial service providers must follow a 'double layer' or 'transnational pro rata' framework with two distinct rules depending on the nature of the costs:

- Where costs borne by a foreign branch have a direct link to the head office's taxable supplies, a straightforward recovery right exists to the extent those supplies would be taxable if within the VAT scope of the Member State where the branch is located.
- For the general costs of a branch used for both its own transactions and those of the principal establishment in another Member State, account must be taken in the denominator of the pro rata fraction of transactions carried out by both the branch and the head office, with only those head office transactions appearing in the numerator in respect of which VAT would also be deductible if they had been carried out in the State of the branch.

This complicates the treatment of input costs for multinational groups. In the case of support costs provided by the branch to the head office in making a mix of taxable and exempt supplies, the requirement to "ring-fence" specific costs and to understand the relevant VAT treatment in each location may generate technical and practical complexities, particularly where a branch acts as a hub providing support to its wider network. Businesses across Europe may, as a result, need additional data and resources to support a recovery entitlement. Input VAT recovery depends on the VAT rules of two jurisdictions simultaneously, possibly creating inconsistency where Member States have not issued guidance.

3.1.7 Summary of key findings

The conclusions of the legal analysis are largely in line with those from the previous study, mainly because **changes in the meantime have been limited**. In particular, the stream of CJEU judgments in the area of financial services has somewhat dried up, with few new cases having been adjudicated since 2020[138]; the VAT Committee has also seldom worked in this area in recent years[139]. The main changes concerned the

[137] Judgment of the Court of 24 January 2019, Morgan Stanley & Co International plc v Ministre de l'Économie et des Finances, Case C-165/17.

[138] Cf. Judgment of the Court of 9 March 2023, *Generali Seguros SA v Autoridade Tributária e Aduaneira*, C-42/22, ECLI:EU:C:2023:183; Judgment of the Court of 25 March 2021, *Q-GmbH v Finanzamt Z*, C-907/19, ECLI:EU:C:2021:237; Judgment of the Court of 1 October 2020, United Biscuits (Pension Trustees) Ltd and United Biscuits Pension Investments Ltd v Commissioners for Her Majesty's Revenue and Customs C-235/19, ECLI:EU:C:2020:801; Judgment of the Court of 6 October 2022, *O. Fundusz Inwestycyjny Zamknięty reprezentowany przez O v Dyrektor Krajowej Informacji Skarbowej*, C-250/21, ECLI:EU:C:2022:757; Judgment of the Court of 18 November 2020, Franck d.d. Zagreb v Ministarstvo financija Republike Hrvatske, C-801/19, ECLI:EU:C:2020:1049; Judgment of the Court of 20 January 2021, K v Staatssecretaris van Financiën, C-58/20, ECLI:EU:C:2021:49; Judgment of the Court of 2 July 2020, *BlackRock Investment Management (UK) Ltd v Commissioners for Her Majesty's Revenue and Customs*, C-231/19, ECLI:EU:C:2020:513; Request for a preliminary ruling lodged on 12 October 2022, *X v Inspecteur van de Belastingdienst Utrecht, Rechtbank Gelderland*, C-639/22; Judgment of the Court of 4 July 2024, *Finanzamt T v [party not specified]*, C-184/23, ECLI:EU:C:2024:599; Judgment of the Court of 9 February 2023, *Euler Hermes SA v Administración del Estado*, C-482/21, ECLI:EU:C:2023:83.

[139] *Cf.* Guidelines Resulting from The 120th Meeting of 28 March 2022 Document A – taxud.c.1(2023)3629452 – 1044; Digital payment services – Selected issues in e-commerce (e-wallets, marketplaces and "Buy Now, Pay Later" offerings)

four Member States having introduced VAT groups, a further decline in the countries permitting CSAs and the deduction method of other actual usage, and one more Member State (Poland) having introduced the option to tax. The former two changes serve to level the playing field, while the latter increases diversity, since the option to tax remains available only in few Member States (and with differing rules and scope). There remains some divergence across Member States on the definitions of financial services, and hence on the scope of the exemption, which is more visible for certain activities (e.g., asset management, the insurance value chain, derivatives).

3.2 VAT/GST regime for financial services in third countries

This section describes the consumption tax systems for financial services in a selection of third countries. The countries considered include key trading partners of the EU as well as countries where the VAT or Goods and Services Tax (GST) differs interestingly from the EU VAT exemption framework, either in terms of the scope of application or for the deduction rules. The objective of this analysis is twofold:

- identify existing approaches, verify their workability and thus get inspiration for the definition of the policy considerations.
- contribute to the comparative assessment of the impacts of the EU VAT framework on competitiveness, in Section 7.3 below.

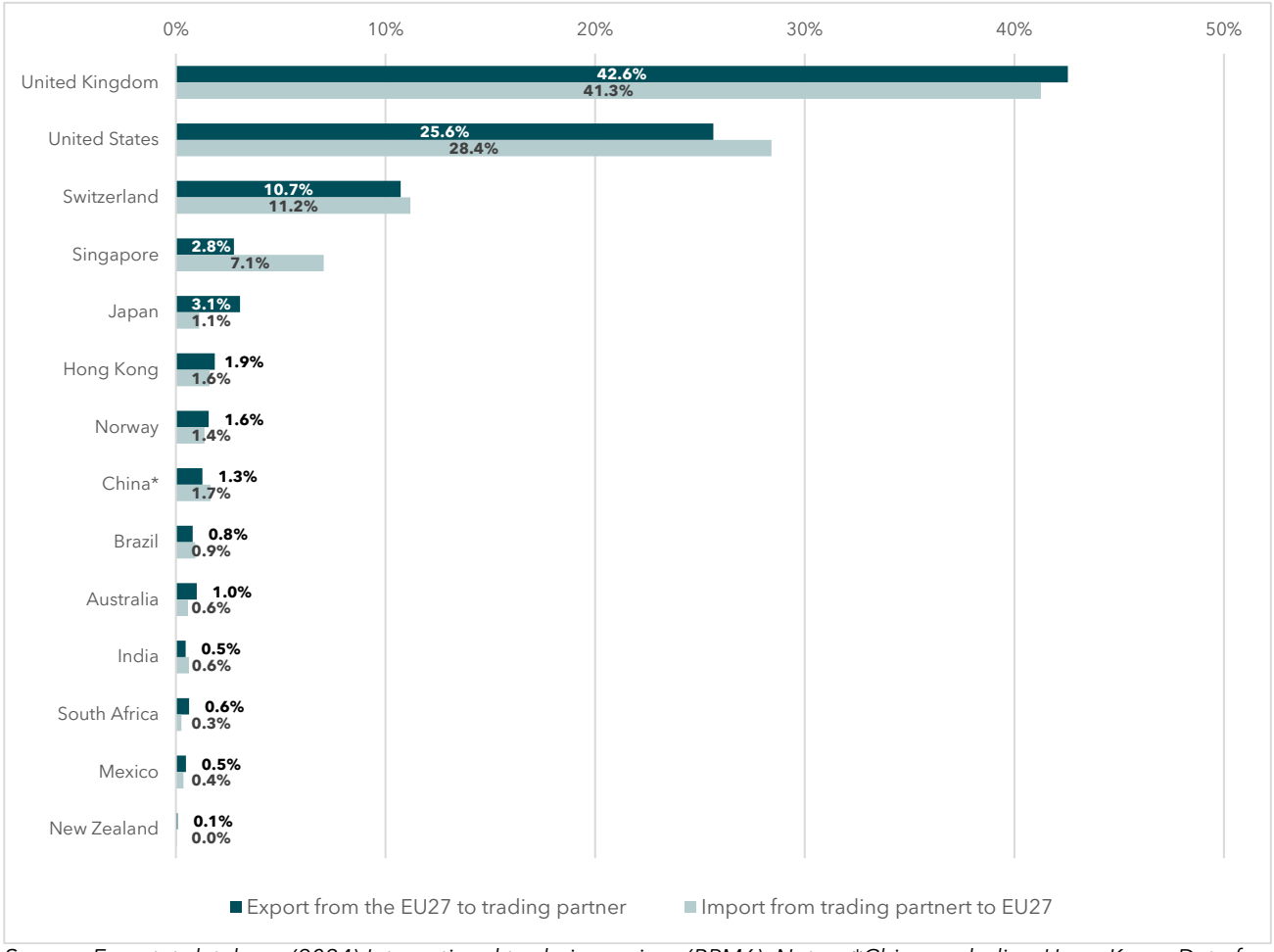
The information is largely based on interviews with local tax experts and desk research; whenever possible, primary sources such as local laws and regulations have been reviewed to help produce an accurate and up-to-date analysis.

The **analysis has focused on fifteen countries**[140], of which all but two – the US and Hong Kong – have a VAT/GST system. Unsurprisingly, since Brexit, the major EU trading partner has been the UK, followed by the US and Switzerland, which are EU main counterparts from a financial services perspective. Together, these three countries represent more than half of the EU's trade in financial services with third countries, while others account for much smaller shares. Figure 9 below provides a breakdown of the EU's trade with the selected jurisdictions, in terms of both imports – i.e. services imported into the EU from third counties, and exports – i.e. services supplied from the EU to partner countries.

(Document taxud.c.1(2022)1614863 – Working paper No 1038); Guidelines Resulting from The 120th Meeting of 28 March 2022, DOCUMENT B – taxud.c.1(2023)3625373 – 1045; VAT treatment of crypto-assets (Document taxud.c.1(2022)1585400 – Working paper No 1037).

[140] Russia was also a significant partner up until 2022 when the volume of trade fell dramatically due to Russia's invasion of Ukraine. Its taxation regime is thus not covered. It should also be mentioned that Hong Kong, while a special autonomous region of China rather than a 'country', has its own tax and trade policies and is thus included separately in the analysis.

Figure 9. Share of total exports from the EU to main trading partners of financial services, and share of total imports of financial services into the EU from main trading partners (2023)



*Source: Eurostat database (2024) International trade in services (BPM6). Notes: *China excluding Hong Kong. Data for Ecuador not available*

Table 8 categorises the countries reviewed according to two key dimensions: the **scope of the exemption** and the **deduction regime**. Both dimensions are important in terms of potential impacts on aspects of interest like administrative complexity, business models, tax revenue generation and competitiveness.

The **scope of the exemption** concerns the breadth of financial services covered. A broad scope means that VAT is charged on relatively few supplies, but at the price of significant costs for hidden VAT and distortions to the value chain. This is the case in three of the countries considered. Of the remaining eleven countries with VAT/GST systems, seven apply a narrower exemption, taxing at least some services that are exempt in the EU, in particular fee-based services, while one (China) has taxed all financial services since 2016, and Brazil recently approved a reform that will apply VAT on all financial services starting from 2026.

In terms of the **deduction rules**, the analysis examines the extent to which input VAT can be deducted, which is closely tied to the scope of the exemption. In China and Brazil, where full taxation applies, businesses enjoy a full right of deduction, whereas in countries where supplies are mixed taxed and exempt, companies can only reclaim a portion of the VAT paid on purchases and expenses. This can however be regulated through different regimes which include proportional deduction, sector specific regimes or fixed rate deduction (or a mix of the last two).

Taken together, four categories of countries emerged, as shown in the Table 8. These are discussed in turn in the following sections.

Table 8. Overview of third countries VAT systems as applied to financial services

	Country	Scope of the exemption	Deduction regime
EU neighbours with similar VAT exemption regimes	United Kingdom[141]	Mostly exempt	Proportional deduction
	Switzerland	Mostly exempt	Sector-specific deduction regime
	Norway	Mostly exempt	Proportional deduction
VAT / GST on certain services	Japan	Partly taxable (certain fee-based services)	Proportional deduction
	Mexico	Partly taxable (certain fee-based services)	Proportional deduction
	Ecuador	Partly taxable (certain fee-based services)	Proportional deduction
VAT / GST on certain services and generous deduction rules	New Zealand	Partly taxable (certain fee-based services; zero-rating for B2B supplies)	Sector-specific deduction regime
	India	Partly taxable (certain fee-based services)	Special rules for deduction with fixed rate
	South Africa	Partly taxable (certain fee-based services)	Sector-specific deduction regime
	Singapore	Partly taxable (certain fee-based services)	Sector specific deduction regime with fixed rate
	Australia	Partly taxable (certain fee-based services)	Special rules for deduction with fixed rate
VAT on all financial services	Brazil	Full taxation (difference between fee and margin-based regime)	Full deduction with some exceptions
	China	Full taxation	Full deduction
Countries without VAT/GST	United States	No VAT/GST	Not applicable
	Hong Kong	No VAT/GST	Not applicable

Source: Authors' elaboration based on desk research and consultation with third-country experts

[141] While generally similar to the EU VAT exemption framework, the UK applies a more flexible approach to VAT grouping which may confer advantages in terms of reducing hidden VAT, as discussed below.

3.2.1 EU neighbours with similar VAT exemption regimes

The first set of countries that can be grouped together are neighbours to the EU, namely Norway, Switzerland and the United Kingdom. In these countries the exemption regimes are broadly similar to the EU one, with some particularities concerning deduction methods.

- **United Kingdom: mostly exempt, proportional deduction.** The VAT treatment of financial services in the United Kingdom has remained largely unchanged since Brexit: exempt services include granting and negotiating credit, trade in financial instruments (like stocks and bonds), insurance transactions, and managing qualifying investment funds[142]. Since the legal framework has seen no changes, similar challenges to those faced in the EU persist in the UK. For instance, the scope of VAT exemption can be unclear, particularly for complex products. Relatedly, stakeholders remark on a growing need to update the legislation to properly handle innovative financial products.

  As most financial services are VAT-exempt, providers of these services typically cannot reclaim VAT on input costs. For proportional deduction, direct attribution is used for inputs used for taxed or zero-rated transactions. For mixed inputs, the approach used is in line with the Member States classified as 'liberal' in Section 3.1.6. For financial services other than insurance, companies use a value-based calculation[143] by default. Alternatively, financial services can agree 'Partial Exemption Special Methods' (PESM) with the tax authority. These methods can be negotiated with the tax authority to achieve a more precise calculation for input VAT recovery[144].

  Notably, though the VAT framework has not changed since Brexit, the supply of services made from the UK to EU customers are now exports, and thus zero-rated[145]. Brexit has thus increased the scope for input VAT recovery in the UK, with potential impacts on the competitiveness of the financial industries in the UK vs EU. At the same time, supplies made from EU providers to UK customers have also become exports and are thus zero-rated.

  The UK approach to VAT grouping merits special mention. While previously applying VAT grouping in a restrictive fashion, this position was relaxed in 2025 without a change in legislation[146]. It was thus confirmed that non-UK establishments of UK businesses can be included within a UK VAT group[147] such that supplies of services between the non-UK establishment and the UK head office are treated as outside of the scope of VAT (see discussion in Section 3.1.4). This in principle would give UK financial service providers greater scope to reduce hidden VAT than in the EU. However, this treatment is subject to anti-avoidance provisions, and the actual impact on VAT liabilities has

[142] HM Revenues and Customs, VAT Notice 701/49: finance.

[143] Cf. VAT Notice 706, 9.4, "Supplies described in items 1 (ed. Issue, transfer or receipt of, or any dealing with, money, any security for money or any note or order for the payment of money) and 6 (Issue, transfer, receipt or dealings with any security or secondary security) of Group 5 of schedule 9 to the VATA 1994 (mainly supplies of financial instruments such as shares and bonds) and supplies made from overseas establishments are catered for by the standard method but are excluded from the values-based calculation, irrespective of their place of supply. Instead, input tax wholly or partly relating to these supplies is ring-fenced and recovered on the basis of the use of the purchases in making UK taxable and 'foreign' and 'specified' exempt supplies".

[144] This is particularly critical in asset financing arrangements, where the interplay between capital value and interest charges complicates VAT pro-rata calculations.

[145] More precisely, these UK exports are outside the scope of VAT, with the right to deduct – see The Value Added Tax (Input Tax) (Specified Supplies) Order 1999 (SI 1999/3121) as amended.

[146] HM Revenues and Customs (2025), Revised VAT grouping rules and the Skandia judgment, available at: https://www.gov.uk/government/publications/revenue-and-customs-brief-7-2025-revised-vat-grouping-rules-and-the-skandia-judgment/revised-vat-grouping-rules-and-the-skandia-judgment (last accessed May 2026).

[147] Regardless of whether the overseas establishment is in a local VAT group and is treated as a separate taxable person locally.

not been assessed for the purposes of this study. In addition, UK establishments of non-UK entities may be included in a UK VAT group provided that the conditions for VAT grouping are met[148].

- **Switzerland: mostly exempt, sector-specific deduction regime**. The Swiss VAT framework[149] exempts the supply of financial services from VAT. The exemption largely corresponds to Article 135(1)(a)-(g) of the VAT Directive, with a limited number of differences. The partial revision of the VAT Act of 2023[150], taking effect by 2025, has not introduced any major reforms. The only noteworthy change is the expansion of the exemption to include the offering of investments by investment foundations and their management. While an option to tax exists for other exempt services[151], this option does not apply to financial services.

  As for input VAT, there is no right of deduction for inputs used for the realisation of exempt services. As in the EU, VAT on inputs directly attributable to taxed transactions can be deducted. For mixed inputs, a pro rata method is applied. However, banks and insurance companies enjoy a tailored deduction regime whose calculation is likely to be more favourable to economic operators than the basic pro rata used in most EU Member States. In particular, for banks: (i) the denominator includes gross interest received discounted by 25%; (ii) fees are included in the formula on a net-basis, i.e., after discounting costs; and (iii) fees for taxed services are augmented by 65% (70% in some cases).[152] As a result, the deduction ratio will be higher, especially as compared to EU Member States which do not use the margin method to calculate the pro rata (e.g., for calculating the pro rata on investment and forex transactions). In contrast, there is no zero-rating regime in Switzerland for supplies to foreign customers (including those established in the EU)[153], meaning that input VAT cannot be recovered in relation to such supplies.

- **Norway: mostly exempt, proportional deduction.** Similarly to the EU, financial services are generally exempt from VAT[154], including:
  - the supply of insurance services
  - the supply of financial services, but not finance leasing
  - the processing of payment orders
  - the supply of legal tender
  - the supply of financial instruments
  - the management of securities funds
  - the management of investment companies

  The difference arises when it comes to **management services**. In the EU, active management services are subject to VAT, while non-active management services (like fund management) are

[148] Cf. Barclays Services Corporation & Barclays Execution Services Ltd v The Commissioners for His Majesty's Revenue and Customs, (2026) UKUT 211 (TCC) (U.K. Upper Tribunal (Tax and Chancery Chamber)).

[149] Article 21(18) and (19), *Legge federale concernente l'imposta sul valore aggiunto (Legge sull'IVA) del 12.06.2009* (consolidated version in force on 1 January 2025). Cf. also the applicable guidelines: *Info IVA 14 concernente il settore finanza* and *Info IVA 16 concernente le assicurazioni*.

[150] Federal Assembly of the Swiss Confederation, Partial revision of VAT Act, November 2023.

[151] Article 22 of the VAT Act.

[152] Cf. Article 66, Ordinanza concernente l'imposta sul valore aggiunto (Ordinanza sull'IVA,) del 27.11.2009; and Info IVA 15 concernente la regolamentazione forfettaria della deduzione dell'imposta precedente per le banche.

[153] The Swiss VAT treatment of financial services provided to offshore passive investment companies hinges specifically on the location of the Ultimate Beneficial Owners (UBOs) of such companies. The services are thus only considered with the scope of Swiss VAT (and therefore exempt) if an offshore passive investment company is predominantly controlled by people domiciled in Switzerland, referred to as "Swiss-owned domiciliary companies abroad".

[154] Norwegian VAT Act, Section 3-6. Entities within the financial services sector in Norway are, in general, subject to a special payroll tax. The tax rate is 5% and shall be calculated on the wage base. Companies where the employees use more than 30% of their time on financial services exempt from VAT will be comprised by the tax.

exempt. In contrast, Norway treats all management services the same, i.e., exempt from VAT, regardless of whether they are active or passive. While most financial services are excluded from VAT, as they are exempt certain activities, such as finance leasing advisory or consultancy services provided by financial institutions, could be subject to VAT if they are not directly related to core financial services. If the business carries out both activities that are taxed and exempt VAT must be reported and paid on the latter activities, and it may deduct input VAT on supplies related to those taxable activities. Deductions in such cases are proportional, based on the ratio of taxable turnover to total turnover[155]. The Norwegian legislative framework also allows for VAT groups. Therefore, if a financial institution is part of a group where other members engage in taxable activities, the group can register as a single entity for VAT purposes provided that at least 85% of the capital in each company is owned by one or more of the cooperating companies. VAT groups are usually permitted for companies, including branches or foreign companies that are registered through Norwegian fiscal representatives.

3.2.2 VAT / GST on certain fee-based services

The second group of countries includes Japan and Mexico where financial services are generally exempt but certain fee-based services are subject to VAT, and where the regulatory framework allows for partial input VAT deduction.

- **Japan: partly taxable (certain fee-based services), proportional deduction**. Japanese consumption tax (JCT) applies at 10% on domestic sales of goods and services as well as upon importation into Japan. Similarly to the EU, there are a number of transactions related to financial services which are exempt from taxation, including:
  - Sales of securities and similar instruments, including foreign securities
  - Monetary transactions including loans and guarantees,
  - Distributions from joint operations trusts
  - Insurance premiums

  Zero-rating is available only for exports.[156] While core financial services are exempt, certain fee-based services supplied by financial institutions are subject to the JCT. These include services where explicit fees are charged, such as money transfers, current account fees, underwriting of financial instruments, credit fees, and certain credit card fees as well as advisory services. This distinction ensures that additional services rendered by financial institutions contribute appropriately to the tax system.

  Input VAT is either recoverable based on the pro rata, or, when possible, direct attribution, where inputs are firstly directly attributed to taxed and zero-rated transactions, and the residual input VAT is recovered based on the pro rata. When the pro rata method is chosen, it needs to be retained by the taxpayer for at least two years.[157]

- **Mexico: partly taxable (certain fee-based services), proportional deduction**. In Mexico, the VAT treatment of financial services is primarily governed by the Value Added Tax Law, which exempts most financial activities from VAT under Article 15[158]. This exemption applies to services such as interest on loans, banking commissions, stock market transactions, and insurance services. However, the law also taxes at the standard 16% VAT rate certain fee-based services, i.e., financial advisory fees, credit card annual fees, and leasing of financial assets brokerage services.

[155] Norwegian Vat Act, Section 8-1.

[156] KPMG (2023) Japan Tax Guide. In 2023, Japan implemented a tax reform, introducing some changes to consumption taxes. However, these do not directly affect financial services, as the reform focuses on the Platform Taxation regime.

[157] KPMG (2023) Japan Tax Guide.

[158] Mexican Value Added Tax Law, New Law published in the Official Gazette of the Federation on December 29, 1978.

- **Ecuador: broadly taxable financial services regime (most fee- and commission-based financial services subject to VAT), proportional deduction**. In Ecuador the law distinguishes between supplies taxed at the standard 15% rate and supplies taxed at 0%, with the latter carrying no right to input tax recovery. Prior to a formal clarification issued by the *Servicio de Rentas Internas* (SRI) in April 2026[159], certain financial and capital-market services were exempt, effectively placing financial institutions in a position where input VAT was irrecoverable and absorbed as a cost. The SRI's clarification reaffirmed that financial services habitually provided by entities forming part of Ecuador's financial system are subject to VAT at 15%, including:
  - Commissions charged to merchants for card payment transactions
  - Fees for domestic and international interbank transfers
  - Charges for mobile and digital payment platforms
  - Other service fees invoiced to clients, users, members, or affiliates

  The input tax deduction mechanism[160] establishes a three-tiered system called 'crédito tributario'. Taxpayers making exclusively standard-rated supplies are entitled to full input tax recovery on all related acquisitions. Taxpayers making exempt supplies have no right to recover input VAT, which is treated as a cost. Where a financial institution makes both standard-rated and exempt supplies, input VAT on shared costs is recoverable on a proportional basis. The proportionality factor is calculated as the ratio of standard-rated turnover to total turnover.

3.2.3 Countries with specific rules to limit the impact of hidden VAT

New Zealand, Singapore, Australia India and South Africa tax some fee-based services. However, compared to the previous group of countries, these also provide for specific deduction rules aimed at increasing deduction rates and thus partly compensating for the breach of VAT neutrality and hidden VAT costs typical of exempt industries.

- **New Zealand: partly taxable (certain fee-based services taxed, zero-rating for B2B supplies), sector-specific deduction regime**. In New Zealand, a GST exemption applies to the supply of financial services (including life insurance contracts and pension funds). The scope of the exemption is mostly in line with the EU one, covering dealings in money and securities, the granting of credit, payment services, bank fees, and related intermediation services.[161] As for insurance, the exemption applies only to life insurance and pension funds[162], while non-life insurance taxable (at 15% GST rate). In 2022, the New Zealand Inland Revenue proposed changes to GST through the 2022 Omnibus Bill, adding the management of funds and retirement schemes to the list of GST-taxable services.[163] Exports of financial services, as well as those linked to international trade, are

[159] VAT Update. (2026). Ecuador confirms 15% VAT on financial services, commissions and related charges for 2025–2026. Available at: https://www.vatupdate.com/2026/04/16/ecuador-confirms-15-vat-on-financial-services-commissions-and-related-charges-for-2025-2026/ (last accessed May 2026) cf also VAT Update (2026). *Tax administration clarifies VAT application on financial services and commissions*. Available at: https://www.vatupdate.com/2026/04/11/tax-administration-clarifies-vat-application-on-financial-services-and-commissions/ (last accessed May 2026).

[160] Article 66 of the Ley Orgánica de Régimen Tributario Interno (LRTI).

[161] Inland Revenue, Exempt supplies, 2021. Available at this link: https://www.ird.govt.nz/gst/charging-gst/exempt-supplies (accessed March 2026).

[162] I.e. superannuation is a benefit paid by the government to New Zealanders once they reach the qualifying age (currently 64 or 65).

[163] Ernst and Young (2022), New Zealand proposes various changes to GST law. Available here_ https://globaltaxnews.ey.com/news/2022-5825-new-zealand-proposes-various-changes-to-goods-and-services-tax-law (accessed March 2026). Starting in 2024, digital platforms will be required to pay GST on "listed services," which, although not including financial and insurance services, could still impact these industries cf Deloitt (2024) GST on digital platforms on digital services, available at this link: https://www.taxathand.com/article/34318/New-Zealand/2024/GST-on-digital-platforms-now-in-force (accessed March 2026).

zero-rated.[164] One of the unique features of the New Zealand GST regime for financial services is the **zero rating of all B2B supplies**. More in detail, from 2004 onwards, supplies to taxable persons (or groups thereof) whose output is at least 75% taxed, are zero- rated.[165] To determine when to apply the zero-rating, a presumption is applied, based on the NACE code of the recipient[166].

According to tax experts, this design is highly appreciated by financial services providers as it is conducive to a higher GST recovery. Many trading banks in New Zealand report recovery ratios ranging from 40% to 50%, depending on the composition of their customer portfolio. The rationale of this system is not only to favour deduction by financial institutions, but also to reduce hidden VAT costs for business customers. From a compliance perspective, the model is relatively straightforward for banks. Customer onboarding processes already include the necessary questions to verify and confirm eligibility for zero-rating. These verifications ensure an accurate identification, without creating significant reporting challenges. The downside, of course, is significantly reduced GST revenue.

Input VAT paid on goods used for taxed and zero-rated transactions is deductible; that on mixed inputs can be deducted based on its actual use, a turnover pro rata method, or sector-wide methods agreed with the tax authorities through a Memorandum of Understanding.[167] These memoranda, while not part of formal legislation, carry quasi-legislative weight: when such an agreement is issued, it references the relevant section of the GST Act. This quasi-legislative status ensures that the agreement is treated with the same authority as a legal act, providing clarity, certainty and consistency for the industry and thus helping to avoid disputes. Since the agreement covers the entire sector, it also ensures a level playing field and consistency across the industry.

- **Singapore: partly taxable (certain fee-based services taxed at 9%), sector specific deduction regime with fixed rate.** Similarly to New Zealand, in Singapore financial services are exempt from the local GST. However, the scope of the exemption does not extend to services facilitating the provision of financial services, such as arranging, brokering, underwriting and advising services provided by banks and other operators, which are taxed at the standard 9% GST rate. Similarly, for insurance services, general insurance is subject to GST, while life insurance and reinsurance remain exempt. If the supply of services qualifies as 'international services',[168] it may be zero-rated.[169] In recent years, the scope of the exemption was revised to include inter alia digital payment tokens[170]. Starting in 2023, the scope of the GST regime was expanded, taxing remote services provided by non-resident service providers to customers located in Singapore. These rules can pose challenges for the financial industry as they can affect a wide range of business activities conducted by foreign banks and branches [171].

  According to the tax experts consulted, given the complexity of GST treatment in financial services, businesses frequently seek clarification from the Inland Revenue Authority of Singapore. Compared to other industries such as manufacturing, logistics, and telecommunications, the financial sector generates more requests for guidance, primarily due to the high compliance standards banks must adhere to. In particular, the rise of e-payment services has introduced new challenges, as multiple intermediaries are often involved in a transaction. Singapore monitors these developments closely

[164] Goods and Services Tax Act 1985 (consolidated version in December 2019), at Sections 3 and 20, at Section 11A.

[165] *Ibid.*, at Section 11A(1)(q) and (r).

[166] Inland Revenue Department, GST guidelines for working with the new zero-rating rules for financial services, October 2004.

[167] *Ibid.*, at § 56 and ff.

[168] International services as defined in Article 21(3) of the GST Act.

[169] Inland Revenue Authority of Singapore, e-Tax guide, GST: Guide for the Banking Industry (sixth edition).

[170] Inland Revenue Authority of Singapore, Digital Payment Tokens. Available at this link: https://www.iras.gov.sg/taxes/goods-services-tax-(gst)/specific-business-sectors/digital-payment-tokens (accessed March 2026).

[171] Deloitte (2023) Overseas Vendor Registration developments: expansion of the scope of GST.

and aims to provide clearer guidelines in the future. The tax treatment of such services depends on the nature of the services provided, the fees charged and whether the services contain elements of guarantees, which could influence their classification as exempt or taxable.

The tax paid on inputs directly attributable to taxed or zero-rated supplies can be deducted, while the residual input tax is deducted under a pro rata regime. However, banks can benefit from a **fixed-input tax recovery rate (FTR)**, whose rates are adjusted each year and depend on the specific type of banking license.[172] The FTR method, was initially a temporary concession, but it has since become a permanent feature of the system. The calculation of FTR is based on industry statistics, ensuring transparency, although individual bank data remains confidential. Starting from 2025, licensed banks can also decide to apply a special input tax recovery method, which allows input tax attribution and apportionment, based on a sectoral method or an output-based method. More in detail, under the special method, banks will be required to separate their input tax into three categories and determine the amount claimable[173]. The use of the Special Method requires approval by the tax authority; if granted, the bank is then required to continue using this method in future years and is not allowed to switch back to the industry-wide deduction rate.

- **India: partly taxable (certain fee-based services), special rules for deduction with a fixed rate**. In India, GST was first introduced in 2017, replacing other forms of indirect taxation. According to the relevant legislation[174], the following financial services are exempt:
  - interest on loans and advances, except interest on credit card payments;
  - currency exchange between banks;
  - payment services for small-value transactions (up to Rp 2,000 – about EUR 20);
  - services provided by recognised financial intermediaries to customers outside India for transactions in foreign currencies;
  - Government Insurance Schemes.

  Cross-border financial services are zero rated, while 18% GST (9% government and 9% regional) applies to fee-based financial services domestically provided by banks and financial institutions, such as processing fees on loans, annual maintenance fees, brokerage and commissions for securities trading, fund management, ATM transactions and interbank fees and digital payments. The rationale for India's approach is to promote financial inclusion by exempting core services such as interest on loans, government-backed schemes and basic savings accounts, thereby reducing costs for low-income individuals, while taxing fee-based services to increase the tax base and the revenue.

  Businesses can claim Input Tax Credit (ITC) for taxes paid on inputs used to produce taxable supplies. For exempt supplies, banking and financial institutions can claim only 50% of the GST paid on inputs and input services as ITC, even when these inputs are used for taxable supplies. This restriction simplifies compliance but does not apply to inter-branch transactions, which are handled

[172] Inland Revenue Authority of Singapore, List of international services – an excerpt of the GST Act. Last updated Apr 2023. The de minimis rule is set out in regulation 28, allowing full input tax credit if the value of exempt supplies does not exceed $40,000 in a month and 5% of the total value of supplies. Regulation 33 allows the deduction of input tax incurred for certain exempt supplies by treating them as if they were attributable to taxable supplies. The underlying policy rationale is that these exempt supplies are regarded as integral to the carrying on of a taxable business.

[173]The three categories are:

(a) Input tax directly attributable to taxable supplies – claimable in full.

(b) Input tax directly attributable to exempt supplies – not claimable.

(c) Input tax directly attributable to both taxable and exempt supplies or for the overall running of the business as a whole ("residual input tax" or "RIT") is to be apportioned. Cf. Inland Revenue Authority of Singapore, e-Tax guide, GST: Special input tax recovery method for banks, 2024.

[174] Notification 12/2017-Central Tax (Rate).

differently. ITC is entirely prohibited for goods and services used exclusively for exempt supplies or personal purposes. By limiting ITC eligibility, this rule streamlines calculations while maintaining alignment with GST provisions specific to the financial sector.[175]

The compliance and enforcement costs under the GST regime for the financial sector are considered high by tax experts, mainly due to the fact that financial institutions must differentiate between taxable and exempt supplies (e.g., fee-based services vs. interest income) and comply with valuation rules for transactions like currency exchange and intra-branch services which can be complex. Restricted ITC eligibility further adds to the operational burden, particularly for mixed-use inputs like IT and infrastructure. For the authorities, monitoring large transaction volumes, enforcing place-of-supply rules, and auditing ITC claims demand significant resources, leading to higher enforcement costs. Frequent disputes arise over issues like the valuation of deemed supplies, bundled services, and ITC eligibility. Fraud risks, including fake invoicing and misuse of ITC[176], also require authorities to invest in advanced analytics and audits. These factors collectively increase the financial and administrative burden for both companies and tax authorities.

- **Australia: partly taxable (certain fee-based services), special rules for deduction with fixed rate.** Australia introduced GST in 2000[177], for which the standard rate is 10%; financial services and certain insurance services are GST-exempt, without the right to claim input tax credit[178]. More precisely, the Australian tax framework defines these services as 'input-taxed sales', since taxation on their consumption does not depend on the chargeability of sales, but on the non-deductibility of input taxes[179]. Exempt financial services include the granting of credit, account and payment services, and transactions in shares, other securities, unit trusts, partnership interests and futures contracts. Input-taxed (exempt) insurance services include life and health policies.[180] In the context of financial supplies, the scope of what qualifies for the exemption is specifically and narrowly defined in the legislation, with comprehensive descriptions.

  This precise definition ensures that the exemption is contained within a specific framework, avoiding broad categorisations that could inadvertently extend the exemption to ancillary or adjacent services. In the case of emerging technologies or business models, such as cryptocurrencies, typically, there is an initial phase of uncertainty where stakeholders attempt to determine the product's classification under existing regulations. Until clarified or amended in legislation, such products might default to an exempt status. While there is always a risk of regulatory definitions either being overly restrictive or insufficiently comprehensive, these challenges are not perceived to present significant systemic issues.

  Exports of financial services towards non-resident customers are zero-rated. As for the treatment of input tax, for regular financial services providers[181], the VAT paid on inputs used for taxed and zero-rated transactions is deductible, while the remaining input VAT is partially deductible. With the explicit purpose of reducing distortions between insourcing and outsourcing, and to level the

[175] Rule 38, Central Goods and Services Tax (CGST) Rules, 2017.

[176] Some examples of tax restructuring to minimise GST liability include separating fee-based services (taxable) from interest-based services (exempt) to reduce overall tax incidence; and offering loans with no processing fees to reduce tax.

[177] A New Tax System (Goods and Services Tax) Act 1999.

[178] Ernst and Young, Worldwide VAT, GST and Sales Tax Guide, 2024.

[179] Australian Government, four exceptions for claiming a GST credit, 2023. More information available here. There are four exceptions where GST credit can be claimed for the purchase of input services: (i) when the purchase occurs through a business or a part of a business outside Australia, (ii) the financial acquisitions threshold is not exceeded, (iii) the purchase relates to a borrowing made, if certain conditions are met, (iv) the purchase is a reduced credit acquisition used to make a financial supply.

[180] Australian Taxation Office, GST and Financial Supplies, QC 17480.

[181] Providers of these services on an incidental basis enjoy full deductibility of inputs under the financial acquisition threshold.

playing field between small and large institutions[182], **a share of the VAT paid on input services which are necessary to produce an exempt financial service can be deducted *ex lege***. This system is called "reduced input tax credits" (RITC) and typically leads to higher deduction than what would be calculated under a proportional deduction regime. More in detail, the RITC provides for the deduction of a certain share – between 55% and 75% - of the input VAT (GST) paid on a vast list of input services (e.g., transaction banking and cash management services, such as managing accounts and processing services, payment and fund transfers services, loan services, etc.).[183] according to tax experts, the RITC approach 'takes out some of the heat' from the system and alleviates tension, thereby enhancing the satisfaction of financial institutions and eliminating the tax-induced distortions between insourcing and outsourcing. In addition, taxable persons who only provide a small share of financial services are excluded from the limitation of deduction (de minimis threshold)[184].

- **South Africa: partly taxable (certain fee-based services), sector-specific deduction regime**. In South Africa, the provision of financial services was previously exempt from VAT as a rule. However, fee-based services became taxable (at a 15% VAT rate) following recent reforms. In 2022, the South African Revenue Service issued a draft binding general ruling, clarifying that securities-lending transactions are considered a provision of credit and, therefore, the fees for these transactions are not subject to VAT[185]. Several recent court cases have emerged regarding how to differentiate between taxable vs exempt services[186].

3.2.4 VAT on all financial services

Among the countries analysed, China and (once its new reform is implemented) Brazil stand out as the only ones applying VAT to all financial services, including the granting of credit. That said, as explained below, Brazil's departs from the usual transaction-by-transaction approach for this purpose, meaning that its approach for interest-based services more closely resembles a turnover tax.

- **China (full taxation, full deduction)** In 2016, China introduced a VAT reform, replacing the previous business tax system for all taxable business activities with a VAT. This reform also extended to the supply of financial services, which are considered as taxable supplies, including both interest income and commission fees. Specifically, for the financial services area there are four group of activities which are taxed: (i) direct financial services (ii) sale of financial products (iii) insurance and (iv) loan interest. The tax rate applied is typically 6%[187]; notable exceptions are interest on deposits paid by financial institutions to customers and claims paid by insurers, which remain outside the scope of VAT. In 2018, an amendment to the VAT law further brought asset management services

[182] Smaller financial and insurance companies are less likely to be able to produce certain inputs in-house, e.g. IT services or investment advisory.

[183] Australian Taxation Office, Goods and Services Tax Ruling GSTR 2004/1, Goods and services tax: reduced credit acquisitions. More information also available here (last accessed March 2026).

[184] By means of a de minimis threshold, minor financial suppliers are removed from input taxing entirely and small players in the GST system can claim full deduction of input tax for the GST they have incurred on inputs associated with making minor financial supplies.

[185] KPMG (2023), South Africa: change in VAT treatment of "scrip-lending" transactions, available here https://assets.kpmg.com/content/dam/kpmg/us/pdf/2023/01/tnf-south-africa-jan13-2023.pdf (last accessed March 2026).

[186] E.g., the case Capitec Bank Limited v Commissioner for the South Africa Revenue Service. Specifically, for Capitec Bank, in its standard contracts, the remuneration for loans include interest, as well as initiation and service fees; loan cover is provided for free. The Constitutional Court found that, although free, the provision of the loan cover was a taxable supply. The Court found that offering loan cover made Capitec's credit more appealing, involving both exempt interest and taxable fees, and classified the loan cover as a mixed supply. It also ruled that unpaid fees did not lose their taxable nature when added to loans and that apportionment of deductions was justified.

[187] China's VAT system operates with three main rates: (i) 13% for goods; (ii) 9% for certain services, including rental activities; (iii) 6% for financial services, although certain transactions within the financial services activities may also be subject to 9% or 13%, depending on their nature.

under the VAT system[188]. The general rule for the taxable base is that VAT for domestic supplies is payable on the gross selling price payable by the recipient[189]. For instance, for asset management services, the taxable base is the total service fees charged to clients; for trade in securities the taxable basis is the fee for trading services or the price differential between sale and purchase price. To streamline the process given the high volume of trades, financial institutions can be taxed on the trading margin at the end of the period, as opposed to being taxed transaction-per-transaction. In the case of insurance services, the taxable base is typically the total premium income received by the insurer. For credit, the VAT base includes both interests charged, as well as any related service fees. Fees on services provided to non-Chinese customers are zero-rated, but interests on loans to non-Chinese customers are taxable.

As financial services are taxed, a major advantage is that the standard (i.e., full) deduction rules apply. However, as in the EU, the Chinese VAT system relies on invoicing for claiming input VAT credit. The complexity of financial transactions reportedly often makes this a challenge, particularly for large institutions managing complex operations.

VAT rules for financial institutions may have an impact on their competitiveness, particularly in cross-border transactions. Taxpayers reportedly face uncertainty due to the evolving nature of the financial services sector and the slow adaptation of the tax regulations to meet business needs. According to the interviewees, clearer guidance from tax authorities, especially in addressing novel financial products and services, could significantly improve the legal framework for VAT on financial services.

- **Brazil: full taxation (difference between fee- and margin-based regime), full deduction.** The scope of services defined as financial services in Brazil is similar to the EU[190]. Currently, fee-based and margin-based financial services (such as loans and security trading) are taxed on the margin – that is, the difference between price and the cost of financial resources – computed respectively on a transaction-by-transaction basis for fee-based services and on an aggregated basis for margin-based services. This margin is subject to a 4.65% PIS/COFINS rate and municipal taxes (2–5% on fee-based services), applied cumulatively[191], not allowing for input tax credits to the users of financial services[192].

  The system is now under reform with the aim of introducing neutrality and transparency in the taxation of financial services, which have historically been under-taxed or distorted due to input VAT restrictions. The reform strives for neutrality while maintaining current tax burdens by

[188] Asset management products are a distinctive feature of China's VAT system. Here, the asset management manager acts as the VAT taxpayer, even though they do not have ownership of the revenue. Managers are responsible for ensuring correct VAT payments and bear liability for any underpayments. This creates administrative and financial challenges, especially given the absence of independent taxpayer designations for asset management investors due to cost considerations. In December 2024, the Chinese government issued new VAT rules that will take effect on January 1, 2026 aimed at streamlining tax administration further and consolidate VAT-related items into a unified system, without introducing any major changes to the VAT exemption framework.

[189] Kpmg (2021) China: VAT Essentials Guide 2021.

[190] The list includes: (i) Credit transactions – lending, financing, factoring, leasing, debt collection, and guarantees; (ii) Foreign exchange operations (iii) Securities and financial instruments – trading, custody, intermediation, and advisory; (iv) Securitization and consórcio administration (v) Fund and asset management, including investment fund administration (vi) Insurance and reinsurance (life and non-life); (vii) Private pensions and capitalization products; (viii) Payment systems – credit/debit card networks, merchant onboarding, transaction processing; (ix) Market infrastructure services – central securities depositories and organized markets; (xi) Virtual asset services.

[191] After the reform is implemented, the current taxes (PIS/COFINS and the municipal tax ISS) on financial services will be replaced by the IBS/CBS. However, the IOF (Tax on Financial Transactions) will still remain for certain financial services. Currently the tax of IOF-Credit on principal lent is 1.88% and 3.5% on foreign exchange.

[192] The absence of input tax crediting under the current system contributed to an estimated 4.5% of GDP in taxation of intermediate goods, disproportionately penalizing sectors with high input content, including financial services operating B2B transactions. Cf IMF (2025) Brazil's VAT Reform: Ensuring Revenue Neutrality, IMF Working Papers, International Monetary Fund.

calibrating specific regime rates[193]. It aims to eliminate hidden taxes and cascading effects, particularly in B2B transactions.

Under Brazil's reformed indirect tax framework, introduced in 2023[194] but not fully in force yet, financial services will be mostly taxable. The new regime will be implemented gradually during the period 2026-2033 and will concern both Brazilian VAT layers[195]. The reform distinguishes between fee-based and margin-based financial services, applying tailored tax rules to each:

- **Fee-based services** (e.g. card processing, fund administration fees and payment arrangements) are taxed under the standard CBS/IBS regime, similar to regular VAT treatment.
- **Margin-based services** (e.g. interest income on loans, gains on currency and securities transactions) are subject to a specific subtraction-based regime, where tax is applied on net revenue after certain deduction in order to adjust it to the get to the margin. This subtraction-based system reduces administrative burdens associated with transaction-level VAT calculation.

To apply the regime, providers of fee- and margin-based services must be supervised by the National Financial System or qualify under law.

Between 2027 and 2033, the combined IBS and CBS rates applicable to financial services will increase gradually each year, from 10.85% in 2027 to 12.50% from 2033 onward, although they may still be adjusted during the transition period, to ensure that the total tax burden does not exceed the levels imposed under Brazil's former regime. Foreign exchange and securities transactions will be taxed at the same rate, regardless of whether they are fee-based or margin-based (calculated as the difference between sales and purchase price). As a consequence of the broader taxability, Brazil's new regime will allow for **full input tax recovery for financial service providers**, a significant departure from typical VAT treatment in many jurisdictions. Providers can deduct the input tax on all goods and services used for taxable supplies, under both regimes.

Purchasers of financial services may also claim credits, depending on the service type:

- **Fee-based services**: full credit is allowed.
- **Margin-based credit services**: input credit is equal to the interest paid minus the risk-free interest rate (SELIC[196]). For FX and securities, no credit is allowed, due to the margin calculation.
- **Insurance**: deductible items include claims paid (when paid to individuals or entities that are not taxpayers of IBS/CBS), refunded premiums, and commissions.
- **Investment funds**: only for investment funds that carry out the taxable transactions (e.g., credit right investment funds and real estate investment funds) a tax credit will be allowed[197].

The reform has already entered its operational transition phase. Since January 2026, a test phase has applied a combined 1% rate (0.9% CBS and 0.1% IBS) on transactions. Amounts collected

[193] Reflecting a constitutionally mandated revenue neutrality requirement, under which the reform must achieve the same tax collection as the current system – approximately 12.5% of GDP, corresponding to the average consumption tax collection during 2012–2021. The final reference rate for the new VAT system from 2033 onwards will be estimates in 2032 Cf. IMF,2025) Brazil's VAT Reform: Ensuring Revenue Neutrality, IMF Working Papers, International Monetary Fund.

[194] Constitutional Amendment No. 132/2023, approved by Congress and promulgated on 20 December 2023.

[195] The VAT system in Brazil consist of one federal tax (CBS - *Contribuição sobre Bens e Serviços*) and a local tax (IBS - *Imposto sobre Bens e Serviços*).

[196] SELIC Interest rate (abbreviation in Portuguese *Sistema Especial de Liquidacao e Custodia*) is one of the most common interest rates in Brazil. This rate is calculated as the weighted average interest rate on overnight interbank transactions secured by securities of the Brazilian Federal Government. At the time of writing the SELIC rate is at 14.75%.

[197] A veto was issued by the President on this point and discussions are underway.

during this period can be offset against PIS/COFINS liabilities, provided taxpayers correctly adapt their ERP and reporting systems.

Challenges and feedback reported for the adoption of this new regime include: (i) classification issues between fee-based and margin-based services, especially for mixed products; (ii) implementation complexity in applying destination principles and revenue sharing across Brazilian states and municipalities. Nevertheless, the model has been well-received for its clear delineation of regimes and its potential to reduce economic distortions. Experts view Brazil's design as a useful example for jurisdictions considering financial VAT reform, particularly in terms of its input credit rules and pragmatic tax base design.

3.2.5 Countries without VAT/GST

Finally, **two of the EU's major trading partners, namely the United States and Hong Kong do not have VAT/GST systems at all**. In the US, the consumption tax – usually called sales tax[198] is regulated at the state level and, traditionally, has been imposed only on tangible goods. Four states (Hawaii, South Dakota, New Mexico, and West Virginia) have started to tax services in general, and several other states have also listed specific services subject to their sales tax.[199] While most states exempt financial services, some states, like Kentucky, Texas and Iowa, include activities linked to financial services within the scope of their sales tax (debt collection or credit reporting might be taxable in certain jurisdictions)[200]. Still, overall, the US financial industry is largely exempt from consumption taxes (Box 2), though state premium taxes may apply to insurance policies[201]; there are also minimal taxes on inputs, reducing costs compared to the EU.

Box 2. Financial services taxation in the US

Financial services in the US are primarily subject to various **direct business taxes**, including traditional corporate income taxes, specialized taxes on capital or shares, and gross receipts taxes (also known as turnover taxes). At the federal level, U.S. resident corporations pay a corporate income tax (21 %) on their taxable income[202], although they may have special accounting or regulatory features.

At the state level, states may tax services generally or impose sales tax on some service categories, but many states exclude financial services from the typical service sales tax base. For example, the state-by-state guide to charging sales tax on services notes that each state treats services differently; but many states exclude financial services.

Because of the regulatory and capital-intensive nature of financial services, some **states impose special taxes** (franchise, margin, bank privilege tax, etc.) rather than a pure sales/service tax. In particular, banks may be subject to taxes on assets, capital, or deposits rather than only on profits. For example, under California's Revenue & Taxation Code, banks and financial corporations are subject to special franchise tax rules according to or measured by net income[203]. In Delaware[204] a special bank franchise tax is applied. This tax is computed on net operating income before tax, with certain adjustments. Delaware also is generally viewed as having no sales tax, and being relatively light on GST-type charges on service receipts.

Similarly, Hong Kong does not have a VAT/GST. Hong Kong's tax system primarily relies on a profit tax, which is levied on the assessable profits of businesses operating within its jurisdiction. For financial

[198] PWC (2023) US Tax Summaries, available at this link https://taxsummaries.pwc.com/united-states/corporate/other-taxes#:~:text=Sales%20and%20use%20tax%20rates,to%20keep%20the%20related%20revenues. (accessed March 2026).

[199] Avalara (2023) US Sales Tax changes, available at this link: https://www.avalara.com/blog/en/north-america/2022/12/january-2023-sales-tax-changes.html (accessed March 2026).

[200] *Ibidem*.

[201] These taxes vary by state (often around 1–3%) and serve as a substitute for regular corporate income taxes in that sector.

[202] PwC (2025), United States - Corporate - Taxes on corporate income, Worldwide tax summaries, available at: https://taxsummaries.pwc.com/united-states/corporate/taxes-on-corporate-income (last accessed November 2025).

[203] Cf CA Rev & Tax Code § 23183 (2024), Article 3 – Tax on Banks & Financial Corporations), available at: https://law.justia.com/codes/california/code-rtc/division-2/part-11/chapter-2/article-3/section-23183/?utm_source=chatgpt.com (accessed November 2025).

[204] Cf Title 5 Del. Code Chapter 11, available at: banking.delaware.gov.

institutions, such as banks and insurance companies, the profit tax is applied to their taxable profits derived from business activities conducted in Hong Kong. The standard profit tax rate is 16.5% for corporations.

3.2.6 Summary of key findings

The **comparative analysis of the global approaches to the application of VAT to financial services** (i.e., the analysis of third countries) shows that the EU is not alone in exempting nearly all financial services and providing for a partial reduction regime based on pro rata or actual use (or both). This approach is replicated, with limited modifications, in neighbouring countries, such as the UK, Switzerland, and Norway. Though in some cases, these confer advantages unavailable in the EU, such as the UK allowing VAT groups to include foreign branches, which may make it easier for multinational providers to reduce hidden VAT.

Other non-European jurisdictions provide for a narrower scope of the exemption, imposing VAT on (some) fee-based services, or providing for zero-rating for B2B supplies. In China, the scope of the exemption for financial services is minimal, and they are largely taxed as standard services, albeit at a low VAT rate (6%). A majority of the jurisdictions considered have adopted special rules for deduction, which result in deduction rates likely to be higher than the EU proportional deduction approach (meaning less 'hidden' input VAT). Combined with the higher share of taxable supplies, this reduces the distortive effect of VAT on outsourcing decisions and the burden of hidden VAT on the financial services sector.

4. Sectoral analysis

4.1 Introduction

The purpose of this chapter is to assess the significance of the financial sector and sub-sectors according to a number of variables, e.g., value added, number of employees, turnover, profitability and cost structure, customer base (in terms of business, household and government segments), and cross-border aspects.

The analysis consists of several elements, as follows:

- **Mapping service providers** in the EU covered by the VAT exemption for financial services and other sectoral taxes in scope of the study.
- **Measuring the magnitude of the sector** in both absolute and relative terms (i.e., the share of financial services activity compared to total economic activity).
- **Assessing cross-border trade** of the financial sector as a relevant factor in tax treatment and potential future changes therein.
- **Assessing cost structures** as an additional element with implications for tax treatment, including employee remuneration and profit margins.

Importantly, as an analytical building block for the study, this chapter focuses on describing the situation with regard to the required parameters. For parameters that could not be compiled from a single, universally accepted source, estimates are provided based on the data that was readily available, with steps taken to minimise any gaps[205] and explanations of any limitations.

The following considerations are particularly relevant for interpreting the findings of this chapter:

- **Consideration of SMEs**: as an assessment of the impacts of different policy considerations support study, it is important for the analysis to understand the role of SMEs in the sector. The key overarching point is that, due to regulatory and commercial factors, the financial sector is dominated by large firms, while SMEs play a very limited role. Moreover, generic datasets, based on the number of employees per company, tend to overestimate the number of SMEs in the sector because true financial players tend to exceed the turnover threshold of EUR 50 million in the EU SME definition. Sector-specific distinctions, which are more meaningful and for which better data are available, are therefore used instead. In particular, in the banking sector the concept of significant institutions and less significant institutions[206], provides a more meaningful analytical framework compared to the concept of SMEs and are used as a proxy. Empirical distinctions are also made where relevant for the analysis (e.g., in Section 7.2 on compliance costs).
- **Context and narrative**: the priority has been to collate and produce the required numerical estimates. In many cases the figures speak for themselves, but for others (e.g., the reasons behind differences in sectoral performance across Member States, and the costs borne by companies for digitalisation, for which reliable sources have only been identified for the banking sector), the data need to be supplemented with further analysis to describe the context.

[205] This is done in various ways, such as by looking at Compound Annual Growth Rates (CAGR) for certain parameters. This term is used to identify the progression ratio for compounding values over a certain time. Briefly, CAGR can be used to explore how a value – e.g., GDP, GVA – evolve along a set of years, given an initial and final value to be calculated upon. CAGR can express the mean annualised growth for the compounded values, being more specific and accurate than a simple mean value. CAGR has been used in the analysis to explore how several elements, as the abovementioned GDP or the employment level of countries, evolve in the analysed timeframe.

[206] Significant institutions comprise the largest and most systemically important banks and are supervised directly by the European Central Bank, while less significant institutions are supervised primarily by national competent authorities under ECB oversight. Cf, Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, ELI: http://data.europa.eu/eli/reg/2013/1024/oj

- **Remuneration structures**: financial services can be priced in two main ways, namely by charging interest, or by charging a commission or fee. Mapping the types and volumes of services using each model is important because it could have implications for tax treatment as part of the policy considerations. Virtually all insurance and other financial services are fee-based. This is also the case for banking services aside from loans, which are interest-based.
- **Profitability and cost structures**: provided for the previous ten years. This has been done for employee remuneration, a key parameter in the costs borne by companies.

The rest of the chapter is structured as follows:

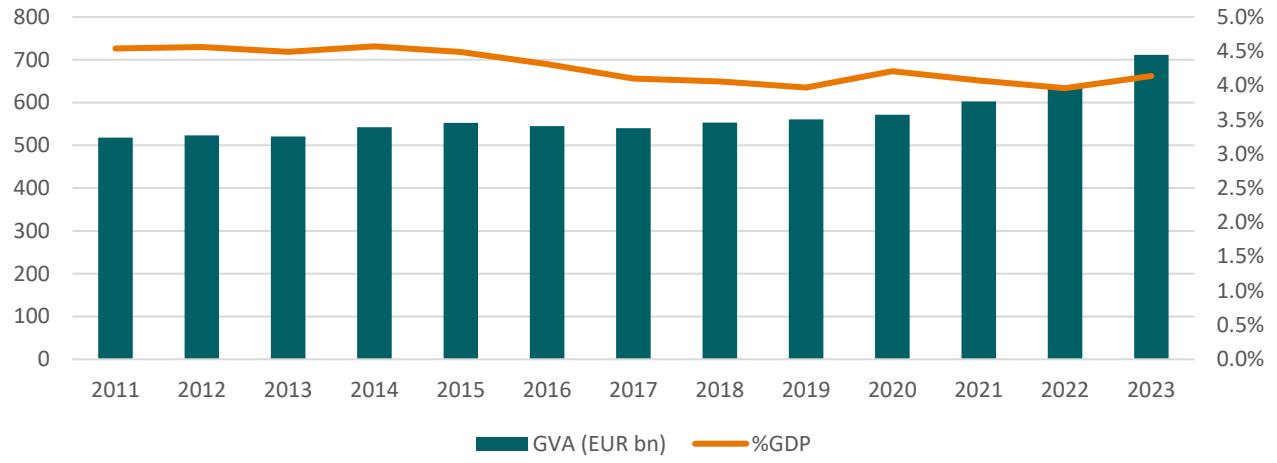
- **Section 4.2** situates the financial sector in the EU economy with an **analysis of its economic relevance and importance**. This includes an assessment of the Gross Value Added (GVA) of the financial sector and its main subsectors (banking, insurance and other financial services as per the typology presented in Chapter2), as absolute values and in relation to Gross Domestic Product (GDP) of the EU and Member States. Numbers of employees are also taken into consideration, in terms of both total persons employed and shares of the workforce.
- **Sections 4.4 and 4.5: detailed analysis banking, insurance and other financial services**, respectively, in terms of the following parameters (with additional information on data sources and limitations provided throughout the text):
    - The **economic importance** of each of the three sub-sectors is measured in terms of GVA share of GDP, and numbers of persons employed (both in absolute terms and as a share of the total workforce), using national accounts data from Eurostat.
    - **Turnover** is defined for the three sub-sectors, with a focus on explaining how this is measured for each sub-sector. This is done based on Structural Business Statistics compiled by Eurostat, with sectoral supply and use tables (SUT) provided for the sake of comparison.
    - The **number of companies** operating in each sector is assessed based on data from sectoral regulators, supplemented where relevant with data from business federations and other sources.
    - For **cross-border activity**, the lack of a single comprehensive database means that several sources are used to piece together the estimates, which are then triangulated considering the place of supply from a VAT perspective. The Balance of Payments (BoP) database offers an outlook of sectoral imports and exports and trends between the European countries. Supervisors' registries and the Consolidated Bank Reports (CBR) from European Central Bank (ECB) provide useful insight on banking services and the presence of branches and foreign institutions in different countries. A similar approach is taken where possible for insurance activities. Another useful source is the data provided by the European Investment Bank (EIB) and the BIS locational statistics. Data is harder to come by for other financial services, which is covered to the largest extent possible using sources such as the reports from the European Financial Market Authority (ESMA) and the European Fund and Asset Management Association (EFAMA).
    - **Profitability and cost-structure data, including employee remuneration**, is derived from the reports of supervisors, such as FINREP-COREP for credit institutions, which make available for all three sectors data on the structure of costs and profits, as well as providing insight on the market environment. This is supplemented by reports from sectoral federations based on surveys of their members.
    - **The breakdown of sectoral output by customer base** - business to business (B2B), business to consumer (B2C) and business to government (B2G) – is a crucial determinant of VAT liability because business customers can usually deduct any VAT incurred, while households and governments cannot. SUT provide the most accurate and comprehensive source, while, for other financial services, supplementary estimates are provided from sectoral federations.

- Section 4.6 concludes the chapter with a brief summary of key findings.

4.2 Economic importance of the financial sector

In 2023, the **financial sector[207] accounted for approximately 4.2% of EU GDP**[208], corresponding to a **GVA[209] of around EUR 700 billion**. Over the period from 2011 to 2023, GVA exhibited steady growth in absolute terms, rising from EUR 500 billion in 2011 to EUR 700 billion in 2023. However, its **relative share of GDP saw a small gradual decline**, dropping from 4.5% in 2011 to 4.2% in 2023, reflecting a minor decline in prominence (Figure 10).

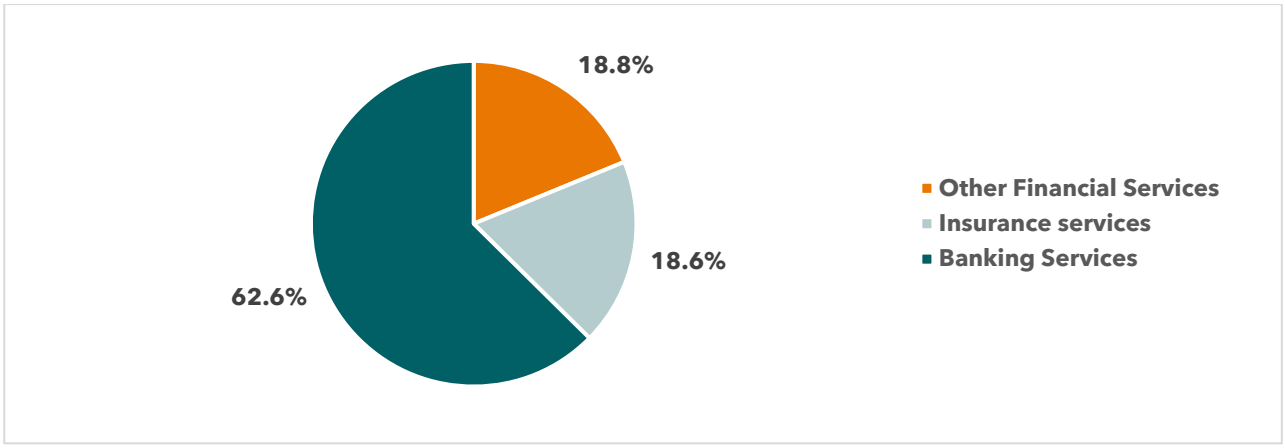
Figure 10. Gross value added of the financial industry (EUR and share of GDP)



Source: Authors' elaboration based on Eurostat, National Account data [210]

As shown in the Figure 11 below, in 2022 almost two thirds of GVA were generated by banking activities, while insurance and other financial services accounted for about one sixth each.

Figure 11. Share of gross value added (2022)



Source: Authors' elaboration based on Eurostat, National Account data[211]

[207] It is considered "Financial Sector" all the NACE Section - K "Financial and Insurance Activities".

[208] EU27 (as from 2020), current prices in EUR billion. Cf Eurostat's National Accounts aggregates by geographical unit. [*nama_10_gdp*].

[209] EU27 (as from 2020), current prices in EUR billion. Cf Eurostat's National Accounts aggregates by industry [*nama_10_a64]*.

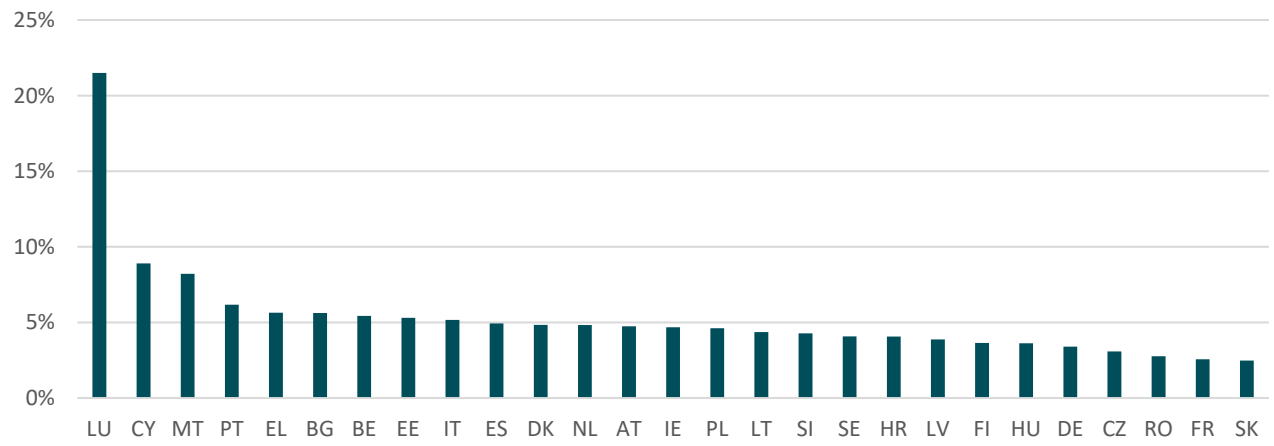
[210] Eurostat datasets nama_10_gdp available at https://doi.org/10.2908/NAMA_10_GDP and nama_10_a64 available at https://doi.org/10.2908/NAMA_10_A64, (last accesses November 2025).

[211] Eurostat, nama_10_gdp available at https://doi.org/10.2908/NAMA_10_GDP and nama_10_a64 https://doi.org/10.2908/NAMA_10_A64 (last accessed November 2025).

The GVA growth of the financial sector observed between 2011 and 2023 corresponds to a **compound annual growth rate (CAGR) of 2.7%**. At Member State level, the GVA evolution reveals varying dynamics. Some countries, such as Lithuania and Malta, have experienced notable growth rates exceeding 10%, highlighting their increasing role as financial hubs, while growth has been more modest in countries like Germany and France where the market is more mature.

Figure 12 shows the wide variation **in GVA as a percentage of GDP**. This is exceptionally high in Luxembourg, exceeding 21%, underscoring its hub status. No other Member State comes close to this level, but other financial centres such as Cyprus and Malta approach the 10% mark, with several others exceed 5%. For most other **Member States, the figure is closer to EU average of 4-5%.**

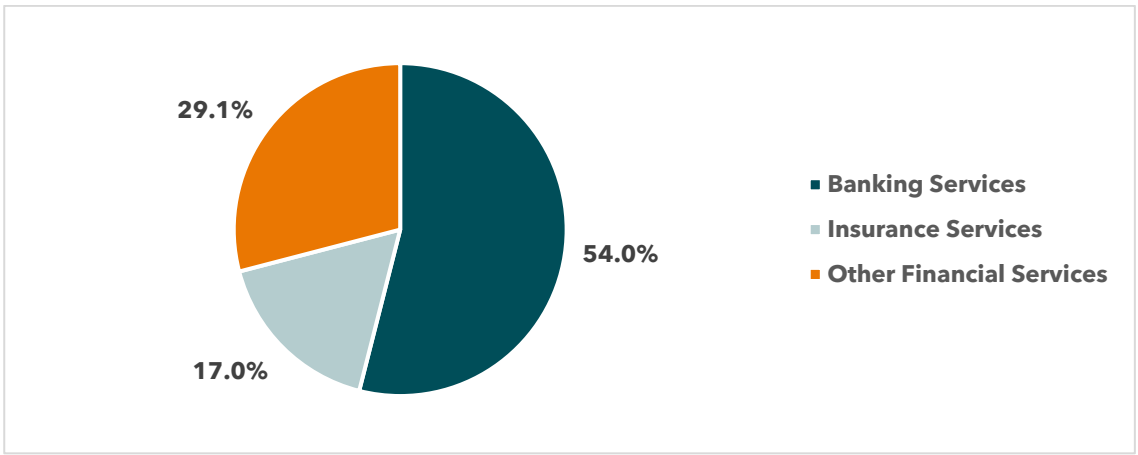
Figure 12. Gross value added of the financial industry per Member State (% of GDP, 2023)



Source: Authors' elaboration based on Eurostat, National Account data[212]

In 2022, the **number of persons employed in financial services represented 2.3% of the total EU workforce**[213], comprising 4.8 million employees. Within this, over **50% work in banking services**, while other financial services account for nearly 30% and insurance around 16.5%.

Figure 13. Percentage of people employed in the financial sector by service typology (2022)



Source: Eurostat, National Account data

[212] Eurostat, nama_10_gdp available at https://doi.org/10.2908/NAMA_10_GDP and nama_10_a64 https://doi.org/10.2908/NAMA_10_A64.

[213] Eurostat "nama_10_a64_e", available at https://doi.org/10.2908/nama_10_a64_e, year 2022, authors' calculations on the relation between the total workforce and the workforce for the K (K64, K65 and K66) sector. (last accessed November 2025).

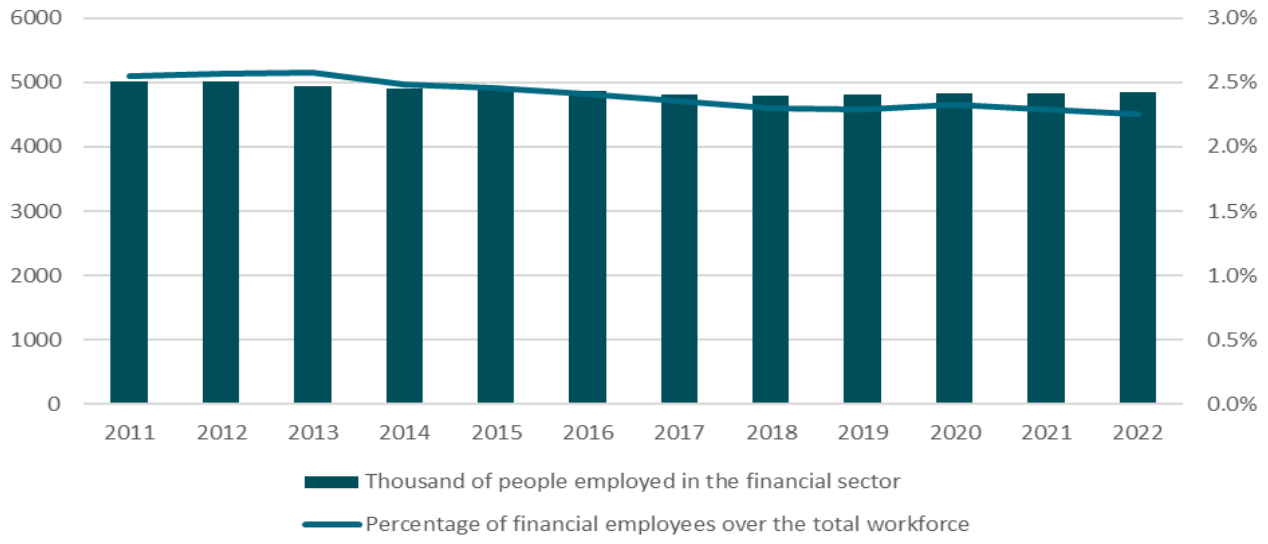
Table 9. Percentage and numbers of persons employed in the financial sector by Member State, 2022

Member State	# employed (thousands)	% total workforce	Member State	# employed (thousands)	% of total workforce
EU27	**4,850.4**	**2.3%**	HU	87.5	1.8%
AT	128.5	2.7%	IE	121.7	4.7%
BE	108.1	2.1%	IT	623.4	2.4%
BG	68.1	2.0%	LT	31.0	2.3%
CY	23.4	4.7%	LU	53.0	10.6%
CZ	95.7	1.8%	LV	16.1	1.8%
DE	1,074.0	2.3%	MT	15.1	5.2%
DK	72.2	2.3%	NL	211.0	2.1%
EE	16.4	2.5%	PL	421.5	2.4%
EL	81.3	1.6%	PT	84.1	1.6%
ES	346.8	1.7%	RO	111.9	1.3%
FI	44.8	1.6%	SE	107.0	2.0%
FR	810.3	2.7%	SI	19.7	1.8%
HR	33.2	2.0%	SK	44.6	1.8%

Source: Eurostat, National Account data

Naturally, **higher shares of employment are seen where the economic weight of the sector is more prominent**. In Luxembourg, it comprises 10.6% of the total workforce. Other countries with a similar trend are Cyprus, with the 4.7%, Malta with the 5.2% and Ireland, with the 4.7%. The employment situation has been largely stable since 2011, albeit with slight decline.

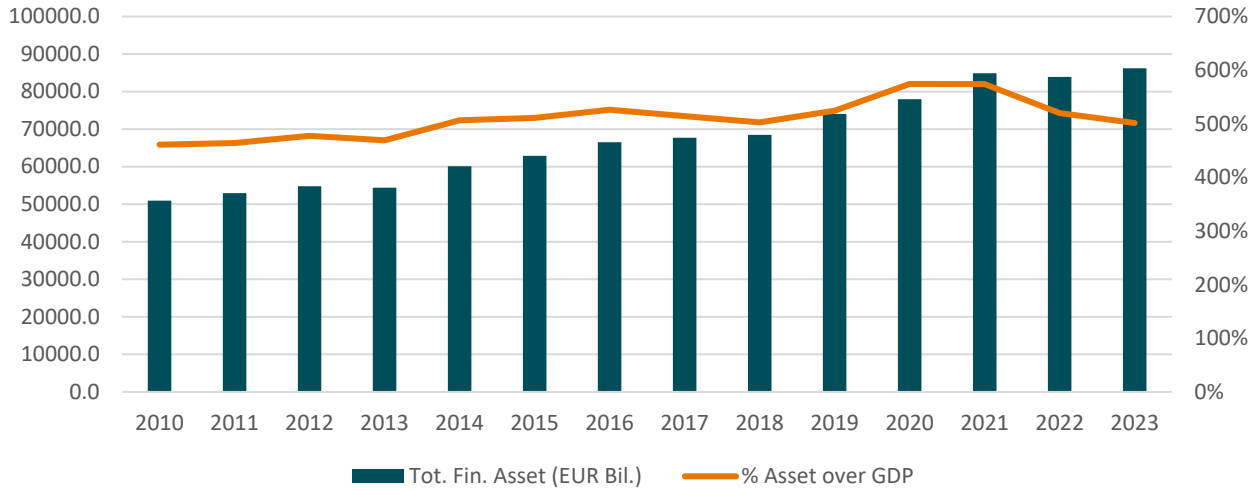
Figure 14. Thousands of people employed in the financial sector in the EU-27 and percentage over the total workforce



Source: Eurostat, National Account data

Another way of looking at the importance of the sector is in terms of its **volume of assets**. Figure 15 shows the quantity, in EUR billion, of assets held by the sector. Assets were gradually increasing until the pandemic and have since moderately fallen back, landing at **EUR 85 trillion** in 2023.

Figure 15. Assets of the financial sector, total and as percentage of GDP (EU27, 2011-2023)

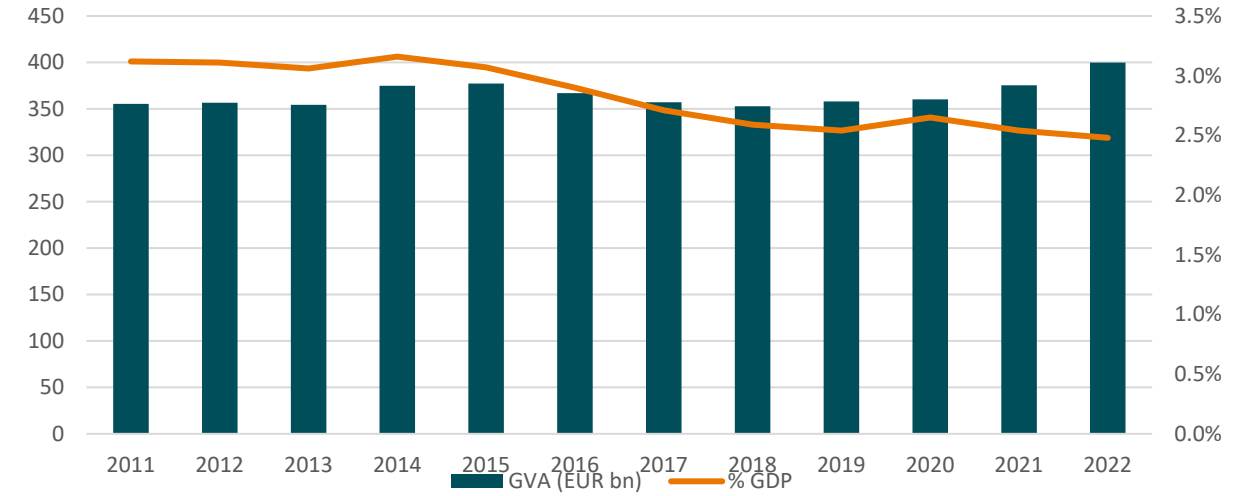


Source: Eurostat, National account data for GDP data and Eurostat, Financial Balance Sheet Data for Asset of the Financial sector[214]

4.3 Banking services

Economic importance. Banking services are the largest of the three parts of the financial sector and generated **GVA[215] of EUR 399 bn in 2022**, as shown in Figure 16. Despite its growth in absolute terms, GVA has been falling relative to GDP [216], from approximately 3.2% in 2011 to just above 2.5% in 2022.

Figure 16. Banking industry Gross Value Added, at EU-27 aggregated level (% of GDP 2011 - 2022)



Source: Authors' elaboration based on Eurostat, National Account data[217]

[214] Eurostat Financial Balance Sheet Data [nasa_10_f_bs]. Sourced from EU 27 (as far from 2020), in current prices in millions of Euros.

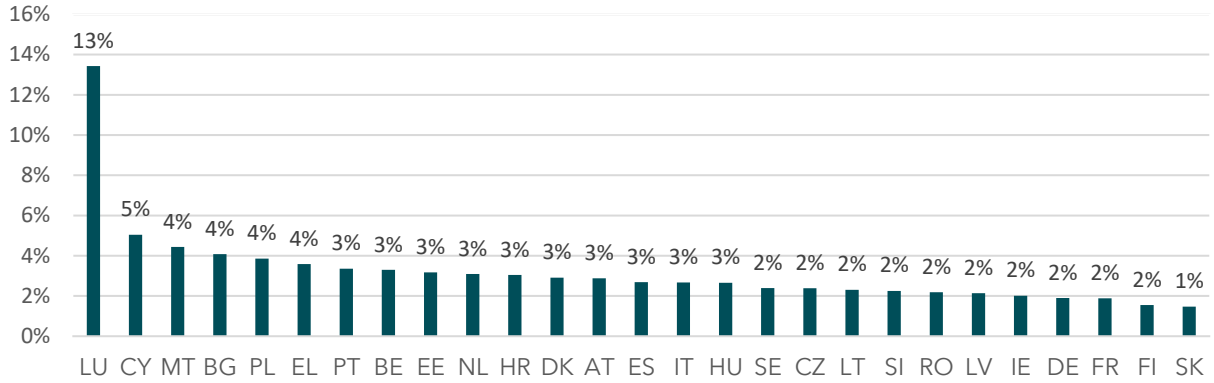
[215] Eurostat's National Accounts aggregates by geographical unit. [*nama_10_gdp*]. Sourced from EU27 (as far as from 2020), in current prices in millions of euros.

[216] Eurostat's National Accounts aggregates by industry [*nama_10_a64*]. Sourced from EU27 (as far as from 2020), in current prices in millions of euros.

[217] Eurostat nama_10_gdp available at https://doi.org/10.2908/NAMA_10_GDP and nama_10_a64 available at https://doi.org/10.2908/NAMA_10_A64, (last accessed November 2025).

On average, the **GVA of the banking industry accounts for approximately 3-4% of GDP** across the EU Member States. Luxembourg stands out with a ratio of almost 15%. Other financial hubs like Malta and Cyprus also exhibit relatively high ratios. In contrast, ratios are below 5% for larger and more diverse economies such as Germany, France and Italy, while banking plays a substantially smaller role in countries like Finland and Slovakia.

Figure 17. Gross Value Added of the banking industry per Member State (% of GDP, 2022)



Source: Authors' elaboration based on Eurostat, National Accounts data[218]

Turnover. For banks, turnover is usually defined as the net operating income, including the following components: (i) net interest income, i.e., the income originated from interest-based services; (ii) net fee and commission income, i.e., the income originated from fee-based services; (iii) net trading income, i.e., the income from trading activities; and (iv) other income, a residual category.[219]

Data was retrieved from the EBA about the geographical breakdown of European banks' main income statement items by location of activities in 2023 and 2024. Table 10 below shows the sum of bank turnovers across the EU-27 level, for significant and non-significant institutions[220], mapped to the four income categories described in the previous paragraph.

Table 10. Bank turnover for significant and non-significant -institutions - total across the EU-27

Turnover components		2023			2024		
		Significant	Non-significant	Total	Significant	Non-significant	Total
Net interest income	EUR mn	378 850	43 187	422 037	387 226	43 488	430 714
	% total	89.8	10.2		89.9	10.1	
Net fee and commission income	EUR mn	166 731	19 839	186 570	180 361	23 171	203 532
	% total	89.4	10.6		88.6	11.4	
Net trading income	EUR mn	46 781	2 415	49 196	50 137	3 339	53 476

[218] Eurostat nama_10_gdp available at https://doi.org/10.2908/NAMA_10_GDP and nama_10_a64 available at https://doi.org/10.2908/NAMA_10_A64 (last accessed November 2025).

[219] Definition of turnover for the purposes of Country-by-Country reporting, 2023_6828 Definition of 'turnover' for the purposes of Country-by-Country reporting | European Banking Authority, EBA (Last accessed: November 2025).

[220] There are four criteria for determining whether banks are considered significant - and therefore under the ECB's direct supervision: size, economic importance, cross-border activities and direct public financial assistance. More details on these definitions and criteria can be found here: https://www.bankingsupervision.europa.eu/framework/supervised-banks/criteria/html/index.en.html (last accessed November 2025).

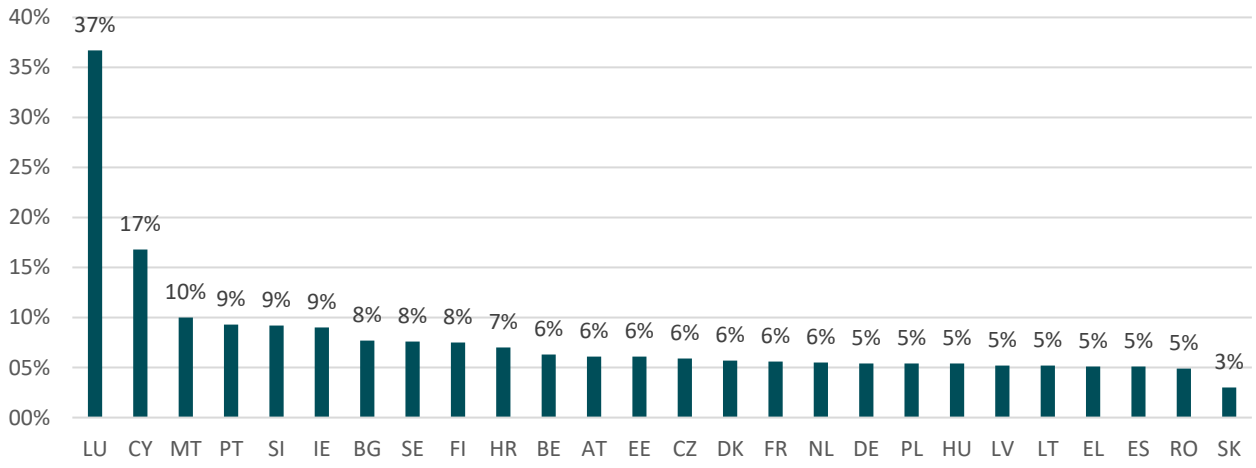
	% total	95.1	4.9		93.8	6.2	
Other income	EUR mn	34 397	5 511	39 908	46 800	7 058	53 858
	% total	86.2	13.8		86.9	13.1	
Total turnover	**EUR mn**	**626 759**	**70 952**	**697 711**	**664 524**	**77 056**	**741 580**
	% total	**89.8**	**10.2**		**89.6**	**10.4**	

Source: Authors' elaboration based on EBA data. Percentages are relative to the row

It is worth noting that the ratios obtained are very close to those found in the previous study: net interest income accounts for 58% of the turnover (also 58% in the previous study), fees and commission for 27% of the turnover (28% in the previous study) while the other two categories make up the remaining 15% (14% in the previous study). These ratios are broadly similar for significant and non-significant institutions.

Due to the sensitivity of the EBA data, breakdowns by Member State are provided using Eurostat SBS[221]. While broadly consistent, the SBS data reports a higher sectoral turnover (ca EUR 900 billion with SBS vs about EUR 700 billion with EBA), which is likely because it captures some companies other than regulated banking entities. Based on SBS, Figure 18 illustrates the sector's share as a percentage of national GDP, while Table 11 adds a detailed breakdown, including both absolute values and their percentages of national GDP. In 2023, **Luxembourg and Cyprus recorded the highest shares of net turnover relative to their national output**. Luxembourg reported a turnover of EUR 29.1 billion, representing 36.7% of GDP, while for Cyprus turnover was EUR 5.3 billion, equivalent to 16.8% of GDP.

Figure 18. Banking industry net turnover (% of national GDP)



Source: Authors' elaboration based on Eurostat, sbs_sc_ovw dataset[222]

Table 11. Banking industry net turnover absolute values (EUR bn) and % GDP in EU Member States

Member State	Net turnover (EUR bn, 2023)	% of GDP (2023)	Member state	Net turnover (EUR bn, 2023)	% of GDP (2023)
AT	28.8	6,1%	*IT*	*Unavailable*	
BE	37.5	6.3%	IE	45.8	9.0%

[221] For the calculation of the turnover, for NACE sectors K64.11, K64.19 and K64.9, the turnover is calculated as value of the output minus subsidies or government grants. In the NACE sectors K64.2 and K64.3, instead, is the approximation in terms of total operating cost – if a financial statement is not offered.

[222] Eurostat, sbs_sc_ovw available at https://doi.org/10.2908/SBS_SC_OVW. (last accessed November 2025).

BG	7.3	7.7%	LT	3.8	5.2%
CY	5.3	16.8%	LU	29.1	36.7%
CZ	18.6	5.9%	LV	2.0	5.2%
DE	227.8	5.4%	MT	2.0	10.0%
DK	21.5	5.7%	NL	58.3	5.5%
EE	2.3	6.1%	PL	40.5	5.4%
EL	11.5	5.1%	PT	25.0	9.3%
ES	75.7	5.1%	RO	16.0	4.9%
FI	20.4	7.5%	SE	40.9	7.6%
FR	157.8	5.6%	SI	5.8	9.1%
HR	5.5	7.0%	SK	3.7	3.0%
HU	10.6	5.4%	**EU27**	**903.8**	**5.3%**

Source: Authors' elaboration based on Eurostat, sbs_sc_ovw dataset[223]

Between 2021 and 2023, **banking sector turnover grew at a CAGR of 9.7% in the EU**. Bulgaria and Lithuania led with exceptional growth rates of 64.3% and 52.1%, respectively, while Portugal (47.2%), Denmark (32.8%), and Poland (30.7%) also demonstrated strong expansion. Moderate growth was observed in countries like Czechia (28.4%), Latvia (24.9%), and the Netherlands (18.8%). In contrast, some Member States recorded minimal or negative growth, including Hungary (-0.4%), Ireland (-2.1%), France (-2.7%), and Sweden (-7.9%).

Table 12. Compound annual growth rate of net turnover in the financial sector across EU Member States (2021-2023)

Member State	Net turnover CAGR (2021 - 2023)	Member State	Net turnover CAGR (2021 - 2023)
EU	**9.7%**	HU	-0.4%
AT	18.4%	IE	-2.1%
BE	10.0%	*IT*	*Unavailable*
BG	64.3%	LT	52.1%
CY	3.4%	LU	15.4%
CZ	28.4%	LV	24.9%
DE	12.2%	MT	14.8%
DK	7.8%	NL	18.8%
EE	32.8%	PL	30.7%
EL	9.6%	PT	47.2%
ES	13.1%	RO	33.5%
FI	6.3%	SE	-7.9%
FR	-2.7%	SI	19.7%
HR	12.8%	SK	8.2%

Source: Authors' elaborations based on Eurostat, sbs_sc_ovw dataset[224]

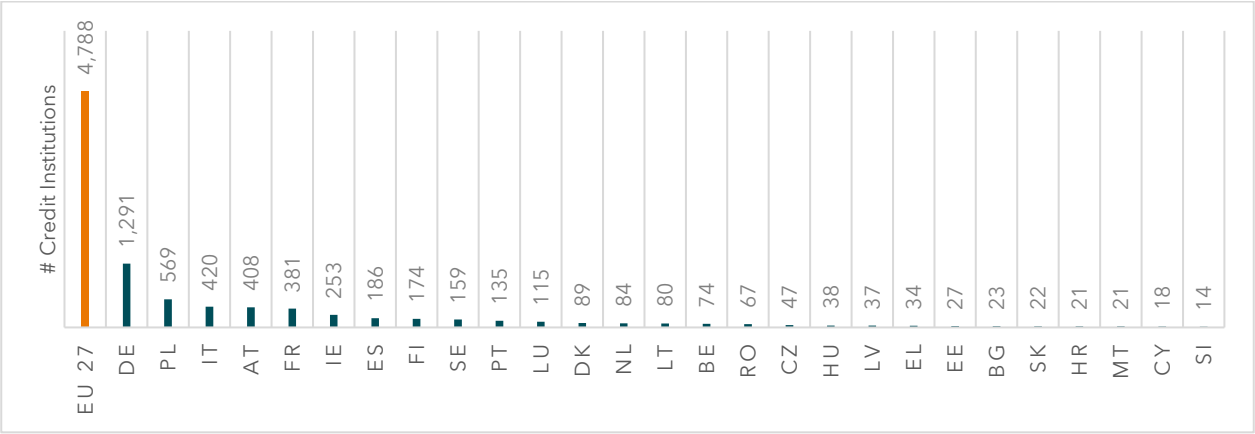
[223] Eurostat, sbs_sc_ovw available at https://doi.org/10.2908/SBS_SC_OVW.(last accessed November 2025).

[224] Eurostat, sbs_sc_ovw available at https://doi.org/10.2908/SBS_SC_OVW (last accessed November 2025).

Number of companies. According to the ECB, there were just under 5,000 monetary financing institutions (MFIs) in Europe in 2023. MFI is a broad definition that includes all the possible institutions that provide funds or issue money in any forms. MFIs include credit institutions (CI), the Eurosystem and all these institutions whose business is to receive or deposit funds. The analysis below focuses specifically on CIs, which are stand-alone banks and banking groups, as they represent the majority of MFIs.

The EU countries with the most CIs are currently **Germany (1,291), followed by Poland (569), Italy (420) and Austria (408).** The number of institutions does not relate directly to GVA or turnover, but rather reflects the structure of the banking sector, with co-operative and savings banks prevalent in certain countries and other systems presenting a larger number of non-banking institutions (see a more detailed description of co-operative banks in Box 3 below). The numbers have been falling in recent years, as part of a trend towards consolidation in the banking sector.

Figure 19. Number of credit institutions by EU Member State (2024)



Source: Authors' elaboration based on ECB, CIs list is updated as of January 2025; EU27 includes the Bank for International Settlements (BIS)

The figures can also be looked at in terms of whether credit institutions are locally based or operating as subsidiaries or branches of institutions based elsewhere.

Table 13. Number of credit institutions by type of establishment (2024)

Type	# of companies
Local credit institutions (CI)	3,969
Subsidiaries/branches of EU-based CI	709
Subsidiaries/branches of non-EU based CI	110

Source: Authors' elaborations based on ECB, MFIs list updated by January 2025[225]

The ECB also provides **data on the size of the banking institutions**. Large, medium and small banks are classified in terms of assets as percentage of total consolidated assets of all EU banks. Large banks or banking groups have a percentage greater than 0.5%. Medium-sized institutions have a percentage between 0.5 and 0.0005%. All the remaining institutions are classified as small. Note that the total differs from the previous tables, since it considers banking groups collectively, even if they include numerous separate entities.

Table 14. Number of credit institutions by size (2023)

Size group	# of companies
Large banks or banking groups	33

[225] ECB data on MFIs and CIs, MFI data access. (last accessed November 2025).

Medium-sized banks or banking groups	772
Small banks or banking groups	1,682

Source: ECB, Data warehouse[226]

[226] ECB data warehouse, available at: https://data.ecb.europa.eu/data/datasets/CBD2/CBD2.A.U2._Z.11._Z._Z.A.A.R0100._Z._Z._Z._Z.LE._Z.PN. (last accessed November 2025).

Box 3. Cooperative banks

Cooperative banks represent a distinctive type of financial institution, characterised by the facilitation of direct ownership by customers (often referred to as 'members'), and the prioritisation of both financial performance and social value for members and the wider community[227]. This enables each member-owner to hold an equal voting right in the major decisions of their financial institution, following the democratic principle of "one person, one vote". Originating in Germany at the end of the 19th century and spreading across Europe over 150 years, they were created to correct what would now be considered a market failure whereby farmers and small businesses were unable to access credit and other financial services. Cooperative banks filled the gap left by traditional financial intermediaries that limited support to these groups due to their perceived diminishing economic potential (in relation to growing industrial sectors) and lack of collateral. By serving member-owners primarily with their own resources and maintaining prudent approaches to risk, they cemented their presence at the centre of community functioning[228]. Because of their unique structure, cooperative banks have a strong relationship with their customers (often member-owners) and territories, representing in many rural areas the main banking entities, with high market shares in several EU countries.

The European Association of Co-operative Banking's (EACB) most recent annual report provides some key statistics on their member institutions' performance in 2023 and their role in the wider European economy. However, some countries are not included, either because their domestic cooperative banks are not part of the EACB network (e.g., Sweden) or because there are no major cooperative bank present (e.g. Malta). Despite their varying prominence, cooperative banks play a significant role, in terms of both people employed and number of banks located in national territories. Indeed, in total, cooperative banks in the EU account for over 680,000 employees and manage assets totalling EUR 8.7 trillion. In countries like France, Germany, and the Netherlands, they hold significant market shares across service categories. In France for example, with groups such as the Crédit Agricole, Crédit Mutuel and BPCE, cooperatives represent collectively 63.3% of deposits, 64% of loans, and 53.2% of both mortgages and SMEs financing. An evolution of the domestic efficiency and market share of cooperative banks is presented in Annex 3.

Table 15. Overview of the cooperative bank sector in the EU (2023)

Country	N. of employees (FT equivalent)	N. of banks	N. branches	Total assets (EUR m)	Market share of domestic deposits
AT	36,108	300	1,569	430,356	41,2%
BG	1,559	Unavailable	290	4,187	5,0%
DK	3,973	41	41	225,719	5,8%
FI	12,650	102	289	160,391	39,2%
FR	338,584	86	11,409	5,153,792	63,3%
DE	171,689	697	7,207	1,597,180	22,1%
HU	648	3	14	4,176	0,4%
IT	29,147	222	4,089	257,694	10,0%
LU	642	1	30	10,765	19,0%
NL	40,467	78	149	613,796	34,7%
PL	26,950	492	3,627	62,650	0,3%
PT	4,136	68	618	25,302	8,0%
RO	1,569	33	695	344	Unavailable
ES	18,041	60	4,156	192,497	0,2%
Totals	**686,163**	**2,183**	**34,183**	**8,738,849**	

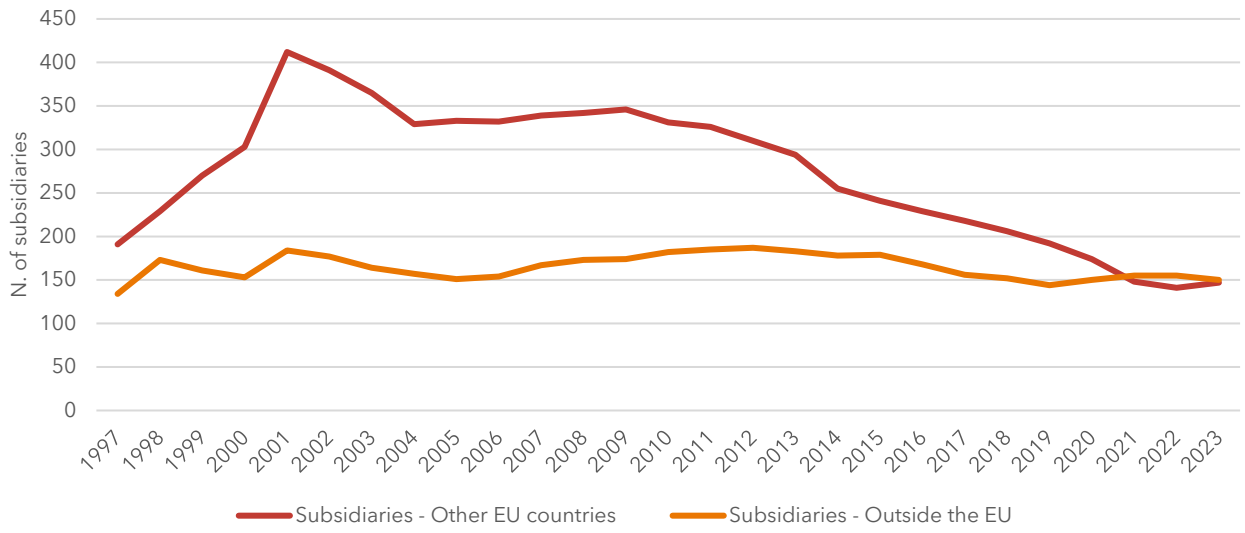
Source: Authors' elaboration based on EACB Key Statistics 2023[229]

Cross-border activity. Quantifying the value of cross-border activities across Europe, a first element to consider is **the presence of credit institutions established outside of the country where their headquarters are based**. These can be classified in terms of branches (which are not separate legal entities from the parent company) and subsidiaries (which maintain distinct legal status in the country of establishment). A total of 504 branches of credit institutions from other EU Member States operate in the

EU, as is also the case for 74 branches of institutions from outside the Euro area[230]. While the number of branches by Member State is not directly available from the ECB data, the European Banking Federation (EBF) has collected some geographical indications, which align partially with the ECB data. According to the EBF, **Spain has the highest number of foreign branches from other Member States (74), followed by France (66) and Germany (58).** Germany shows the highest number of extra-EU branches (45), followed by Italy (35) and Belgium (17)[231].

Regarding the number of **subsidiaries in banking (i.e., CIs)**, this is more difficult to assess because the subsidiaries are legally distinct from the parent company and thus counted as domestic from most perspectives. Still, the *Structural Statistical Indicator* (SSI) of the ECB provides insight on the overarching trend in Europe from 1997 to 2023.

Figure 20. Number of banking subsidiaries at Euro-area aggregated level



Source: ECB, SSI data from 1997 to 2023

As for the other kinds of entities in the banking sector, the **number of subsidiaries of foreign firms has been consistently declining**. The peak in 2000-2001 can be explained by the consolidation of the Euro-area after the official launch of the currency in 1999[232].

Looked at in terms of assets, the Consolidated Bank Data (CBD) indicate the **total assets of these entities in the EU at circa EUR 6 trillion**. This represents **18.8% of the total assets of the banking services** in the EU, which for most purposes is considered domestic business because local subsidiaries of foreign firms are distinct legal entities in their country of operations.

From the perspective of VAT, it is also important to understand the volume of supplies made cross-border, for which an indication is given by the Balance of Payments (BoP) available from Eurostat. Collectively, EU Member States export approximately EUR 117 billion of banking services to other Member States and just

[227] Stefancic, M., Goglio, S., & Catturani, I. (2017). *Democratic Governance Mechanisms in Cooperative Banks: A Reassessment*. Euricse Working Papers, 99(17).

[228] Migliorelli, M., & Lamarque, E. (Eds.). (2023). Contemporary trends in European cooperative banking: Sustainability, governance, digital transformation, and health crisis response. Palgrave Macmillan, 2.

[229] EACB (2023), Key Statistics, available at: Annual reports on Cooperative Banks - EACB. All the data is self-reported solely by EACB member institutions, explaining the lack of many EU Member States and partial numbers for some countries. The proportions of domestic market share for deposits were chosen as they are the most complete in the EACB dataset.

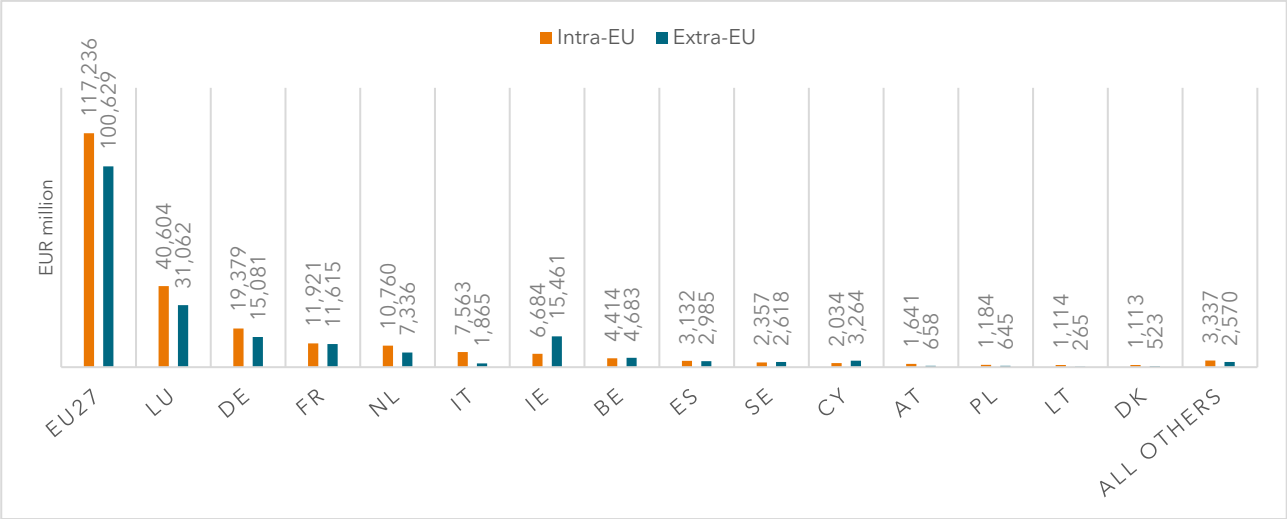
[230] ECB, *MFIs list* updated by January 2025.

[231] EBF "Banking in Europe: EBF Facts & Figures 2024", data based on 2023.

[232] Data from 1997 to 1999 can be read as the trend from countries that will adhere to the 1999 Euro-area at its start.

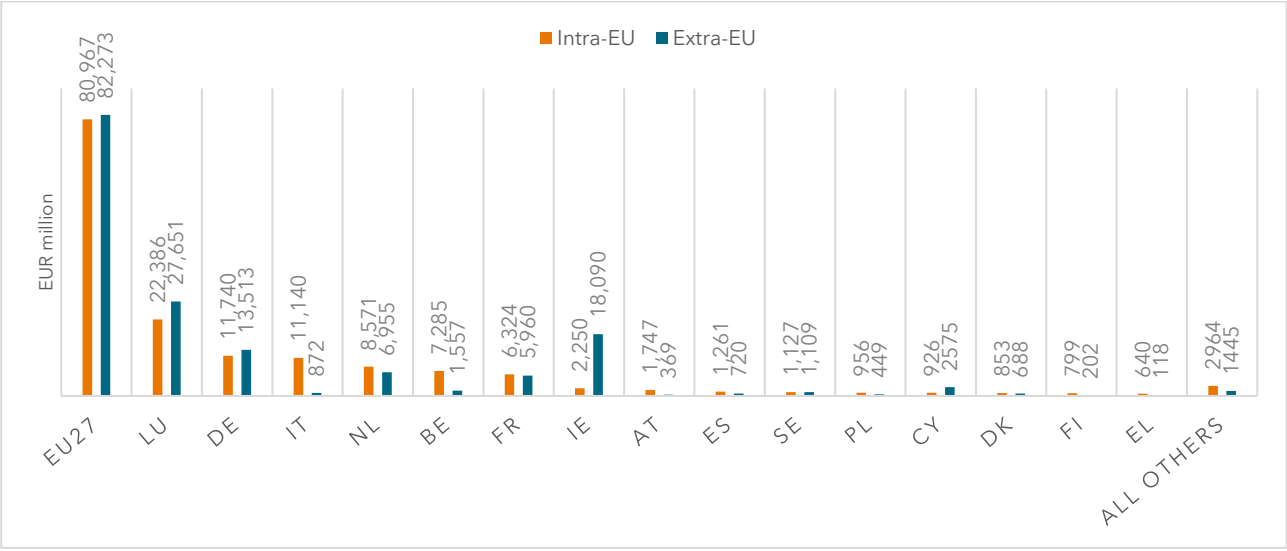
over EUR 100 billion to third countries. While most countries have relatively limited export volumes, **Luxembourg stands out as a major international hub**, exporting EUR 40 billion to EU Member States and EUR 31 billion to third countries. Other significant exporters include Germany, France, Italy, the Netherlands, and Ireland–particularly in relation to third-country clients. **On the import side, overall volumes are lower, but Luxembourg again leads**, importing EUR 22 billion from other EU countries and nearly EUR 28 billion from third countries. Other key importers include the Netherlands, France, Italy, Germany, and Belgium (mainly for intra-EU imports), as well as Ireland for extra-EU imports.

Figure 21. Export of banking services (2023, EUR million)



Source: Eurostat, Balance of Payments – BoP, Eurostat, reference year 2023

Figure 22. Imports of banking services (2023, EUR million)



Source: Eurostat, Balance of Payments – BoP, Eurostat, reference year 2023

To put exports and imports of financial services into perspective, two key ratios across EU Member States are calculated and compared:

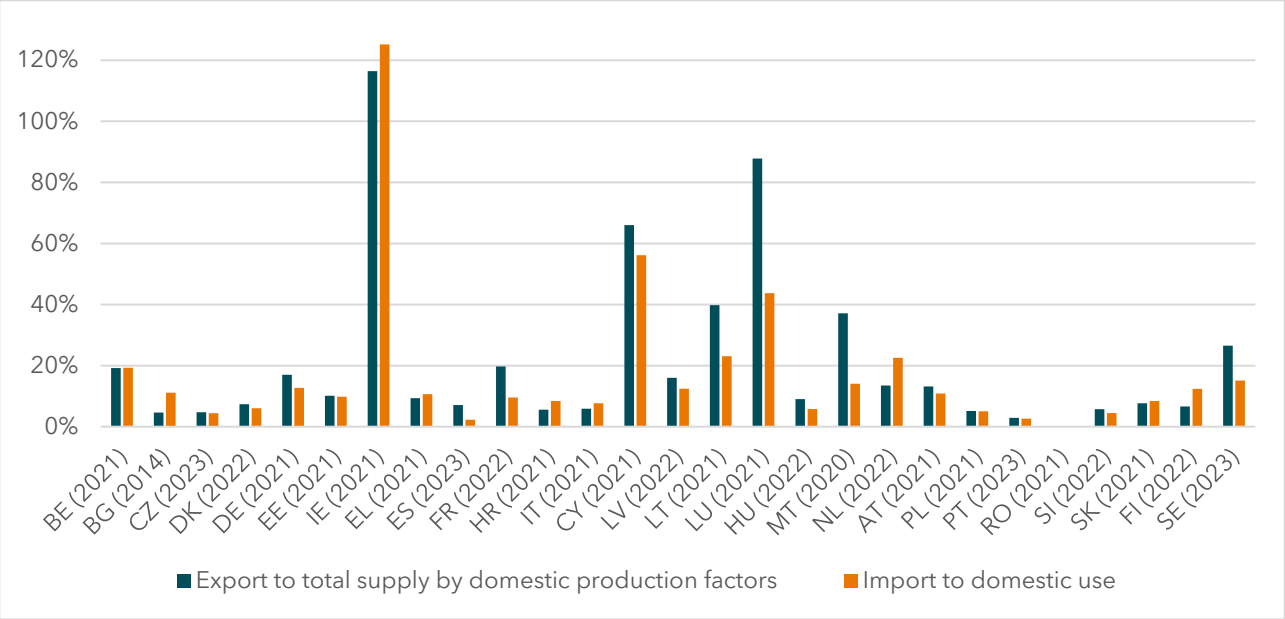
- the ratio of imports – both extra- and intra-EU – to total domestic use, provides a measure of the importance of cross-border financial services to a country's economy;

- the ratio of exports – also extra- and intra-EU – to total supply generated by domestic production factors, acts as a proxy for the export orientation of the domestic financial sector[233].

These indicators are derived using Eurostat's supply[234] and use[235] tables, and present results for the latest year available for each Member State. Although more recent trade data exist in balance of payments statistics, their EBOPS classification is not directly comparable with the CPA classification used in national accounts, particularly for banking services, which limits their usefulness for this analysis. The most up-to-date national accounts data are available for 2021 or later for 25 of the 27 EU Member States.

For banking services (CPA 64), the median export-to-total-supply ratio across Member States was 9.3%, while the median import-to-domestic-use ratio was 10.6%. These two ratios are strongly correlated: countries with a high share of imports also tend to exhibit a high degree of export orientation. The highest values were observed for Ireland (116.4% for exports and 125.2% for imports), Luxembourg (87.8% and 43.7%), and Cyprus (66.0% and 56.1%). In Ireland's case, ratios exceeding 100% clearly point to substantial re-export activity, with imports surpassing domestic use and exports exceeding domestic production.

Figure 23. Relative importance of export and imports of banking services (CPA64)



Source: Eurostat (naio_10_cp15 and naio_10_cp16)

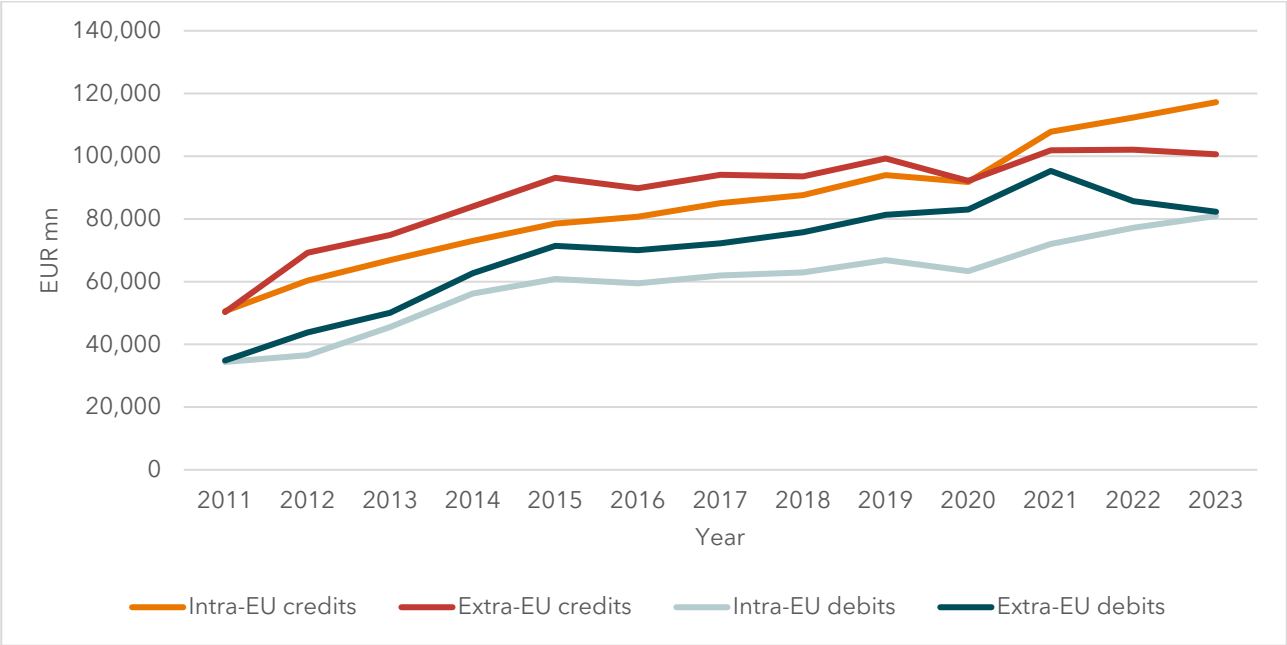
In terms of historical trends, Figure 24 depicts how credits and debts (i.e., imports and exports), at EU level and for third-country partners have evolved in recent years. The trades at EU-27 level – both for credits and debts – have steadily risen from 2011. As shown, for all metrics the trends have been upwards, reflecting growing volumes of cross-border supplies, even if these represent a small share of total turnover for most countries.

[233] Since trade data by sector of economic activity are unavailable, we use the exports grouped by types of services. Naturally, financial services are predominantly supplied and exported by the relevant financial sectors (e.g., CPA 64 by NACE 64).

[234] Eurostat (2025) Supply table at basic prices incl. transformation into purchasers' prices (naio_10_cp15), DOI: https://doi.org/10.2908/NAIO_10_CP15 (last accessed November 2025).

[235] Eurostat (2025) Use table at purchasers' prices (naio_10_cp16), DOI: https://doi.org/10.2908/NAIO_10_CP16.

Figure 24. Credits and debits at EU-27 level (inflation-adjusted)



Source: Eurostat, Balance of Payments – BoP, Eurostat, reference year 2023. Price adjusted for price index for financial services[236]

A last element of cross-border trade concerns the **presence in the EU of banks headquartered in third countries**[237]. According to a report by DG FISMA, these tend to host their European operations in certain hub countries, like Luxembourg (LU), Malta (MT) and Ireland (IE). More specifically:

"IE is the EU Member State where third-country financial institutions have the highest share of the banking market in terms of total assets (45.24% in 2022), while EE, LT, LU, MT, and PT have values in the 20%-40% range. Non-EU banks operating in IE and LU often act as EU hubs for their banking groups and global operations. This explains why the share of third-country banks established in these Member States have a larger share of the EU total interbank deposits compared to their share of the EU total assets. This is also the case for BE and MT"[238]

Despite the relevance across certain countries, overall, non-EU banks maintain a very limited presence in Europe and are mostly linked with international activities. The **countries from which assets in the banking sector are controlled are mainly the United States, the United Kingdom and Japan**, totalling almost 80% of the total assets controlled by foreign banks.[239]

Profitability and cost-structure. Return on equity (ROE) of EU banks in 2023 was 8.6%. This has followed an upward trend in line with increasing interest rates, but the figures have varied significantly between Member States over the years, particularly since the 2008 financial crisis[240]. The **highest profitability in 2023 was found for Cyprus, Hungary, Lithuania and Latvia, which stood between 20% and 22%**. Bulgaria, Croatia, Romania and Slovenia also showed higher than average levels of ROE. In contrast, ROE

[236] Harmonised index of consumer prices (HICP) - ECOICOP ver.2 - indices and rates of change, annual data, https://doi.org/10.2908/PRC_HICP_AINR.

[237] The potential impacts of the tax framework on the operations and location choices of banks is explored in Chapter 8 below on the economic analysis of the tax framework.

[238] DG FISMA, *European Financial Stability and Integration Review 2024*, p.37.

[239] DG FISMA, *European Financial Stability and Integration Review 2024*.

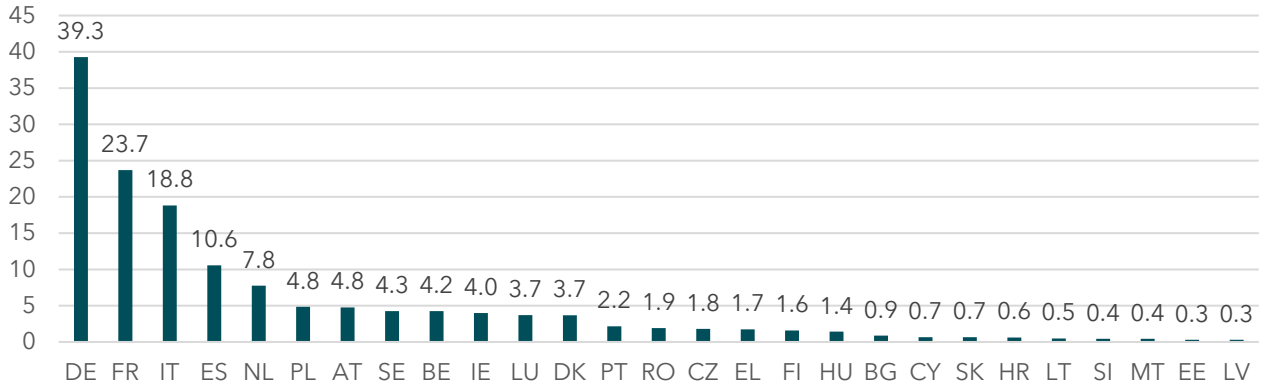
[240] ECB, Return on Equity data, further reported also on EBF, "Banking in Europe: EBF Facts & Figures 2024", data based on 2023.

was lower in Germany, France, Ireland, and Luxembourg, at between 6% and 8%. Dispersion[241] has been stabilising in recent years and settled at **4.5% in 2023 for two consecutive years**.

Regarding **costs**, in line with increasing profitability it can be observed that the **cost-to-income ratio (CIR) fell by 4.9 percentage points in the last year, reaching 55.6% in the fourth quarter of 2023**. This is explained by the increase in net operating income compared to the slower rise in costs. Staff expenses continue to represent one of the largest costs of banks, followed by 'other administrative expenses' (including depreciation) and impairments (i.e., reduction in the carrying amount of an asset below the recoverable amount on the balance sheet)[242].

A key component of costs is comprised of **staff remuneration**, which in 2022[243] was EUR 144.9 billion in banking services. This reflects the aggregate labour cost incurred by employers, including gross wages and salaries paid in cash or in kind, as well as social contributions to statutory and private social insurance schemes. As would be expected, remuneration was concentrated in the Member States with the most important banking sectors in terms of quantity of employees and companies. Germany showed the highest level, exceeding EUR 40 billion, followed by France and Italy. Other countries in the EU show nominal and expected levels of remunerations in accordance with National Accounts.

Figure 25. Employee remuneration in the banking sector across EU Member States (EUR bn, 2022)



Source: Authors' elaboration based on Eurostat, Nama_10_a64 dataset[244]

Between 2016 and 2022, the CAGR[245] **of employee remuneration for the EU averaged 1.3%**. Lithuania showed the most substantial growth, with a CAGR of 19.9%, followed by Estonia at 10.7% and Malta at 7.6%. Conversely, Spain and Greece saw declines in remuneration, with CAGRs of -0.7% and -0.5%. Member States such as Germany, France, and Italy also experienced modest growth rates of 0.4%, 1.8%, and 0.7%, respectively[246].

The cost and profitability structures of banks are also affected by **the growing role of digital technologies**. As discussed in Section 3.2, this is increasingly blurring the line between traditional banks and specialist fintech providers. For example, banking as a Service (BaaS) has emerged as a key investment priority, with 39% of global institutions having progressed BaaS capabilities within their organisations in 2024. Embedded banking services represent another significant investment area, with 36% of global financial

[241] Dispersion is intended as the statistical difference between the average EU ROE and the MSs ROE, meaning greater discrepancies in values between the lowest and highest performers along the years.

[242] EBA, Risk Assessment report of the European Banking Authority, July 2024.

[243] EU27-2020, indicator D11, aggregates by geographical unit. [*nama_10_a64*].

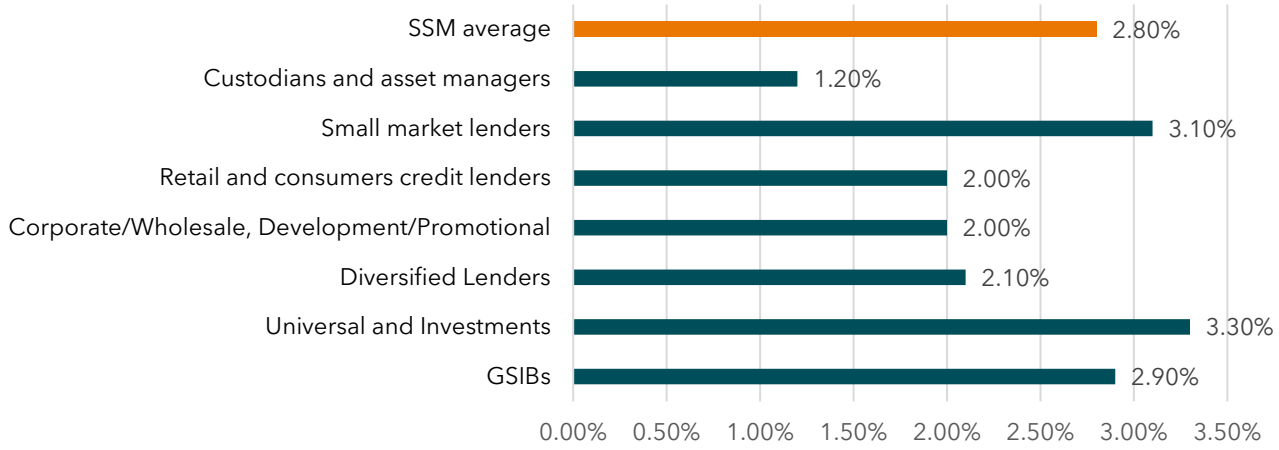
[244] Eurostat, nama_10_a64 available at https://doi.org/10.2908/NAMA_10_A64, (last accesses November 2025).

[245] Eurostat, Nama_10_a64 dataset. More detailed calculation can be found in Volume 2 – Annex 3.

[246] The CAGRs indicated are also directly linked to a broader set of economic factors that warrant consideration. Estonia and Lithuania, for example, present relatively high CAGRs in this sector, which may be attributable to the diffusion of digital banking, inflationary pressures, and above-average economic growth. While sectoral trends are a relevant factor, they must be interpreted within this broader macroeconomic context.

institutions globally having deployed or improved embedded banking capabilities in the last year. These investments seem to reflect the industry's strategic shift toward platform-based business models and ecosystem participation[247]. On average, banks in the EU spend 2.8% of their budget on digital transformation, which varies by type of company as shown in the Figure 26 below.

Figure 26. Spending on digital transformation as percentage of operating income



Source: ECB, Return on Equity data, further reported also on EBF, "Banking in Europe: EBF Facts & Figures 2024", data based on 2023

As Figure 25 makes clear, the **categories of banks spending more on digital transformation are the "Universal and Investments" and the "Small market lenders"**. This is in line with the trend of banks to provide more and more digital services – e.g., applications – for their diverse customer base. Banks also devote increasing resources to the outsourcing of IT services. In a similar line, ECB data shows that cloud expenses for banks have also been increasing from EUR 0.5 billion in 2019 to EUR 1.2 bn in 2021. In the same years, expenses of IT outsourcing activities grew from EUR 13.9 bn to EUR 15.6 bn for activities outside their corporate group. In general, the average of IT outsourcing expenses as a proportion of overall IT expenses reached 47% in 2021[248].

The main takeaway from the exercise of the ECB is the key role digital technologies play in the evolving shape of the banking sector: overall, banks devoted 5.2% of their workforce to digital transformation projects, as of the end of 2021.

As a complement, the EBA also provides data on outsourcing intra-group and from external providers, albeit only among Significant Institutions (SIs). The most recent report, from 2023[249] indicates a growing reliance of SIs on external service providers, which now represents just over half (51.4%) of outsourcing, counting suppliers from both from EU Member States and third countries. As expected, a large part of the services outsourced concern ICT services. These services comprise 47% of all spending for outsourcing (in line with the ECB estimates). Companies externalise and outsource critical services, often based on cloud computing.

Customer base. Eurostat's FIGARO EU Inter-Country Use Tables (2018–2022) were used to analyse how banking services are consumed by businesses (B2B), households (B2C), and the government (B2G). At the EU level in 2022, businesses were the largest consumers, accounting for 73.4% of total banking expenditures, followed by households at 21.6% and the public sector at 5.1%.

[247] Finastra, Financial Services State of the Nation 2024 (February 2025), available at state-of-the-nation-report-2024.pdf. (last accessed November 2025).

[248] ECB, *IT and cyber risk – key observation, SREP 2022*. Not all banks in Europe participate.

[249] EBA Outsourcing Activities, available at Outsourcing register - annual horizontal analysis.

B2B banking grew by 3.7% since 2018, while B2C and B2G grew by 1.7% and 3.3%, respectively. Germany, France, Luxembourg, and Italy recorded the highest B2B expenditures, with Germany leading household (B2C) banking, followed by Spain and France. For government (B2G) banking, Germany, France, and Italy had the largest expenditures. In terms of growth, Malta, Ireland, and Lithuania saw the highest increases in B2B banking, while Malta, Ireland, and Romania led in B2C growth. Ireland, Malta, and Slovakia experienced the most significant growth in B2G expenditures. However, some countries like the Netherlands and Cyprus saw declines, particularly in the B2C and B2G segments. Romania had a notably unbalanced market, with 91.7% of its banking expenditures in B2B services, while household and public sector banking remained small[250].

Table 16. EU 27 customer base for banking services, supply and use tables

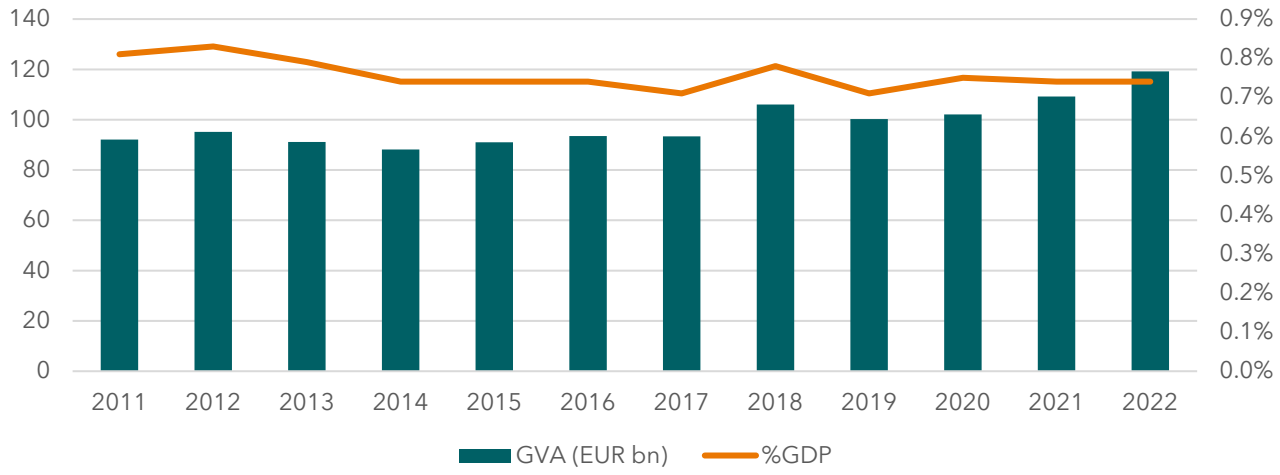
Market segment	Consumption in 2018 (EUR bn)	Consumption in 2022 (EUR bn)	% of consumption in 2022	CAGR of consumption (2018-2022)
B2B	404.7	468.6	73.4%	3.7%
B2C	128.9	137.8	21.6%	1.7%
B2G	28.4	32.3	5.1%	3.3%

Source: Eurostat FIGARO - EU Inter-Country Use Tables (EU IC-SUIOTs)

4.4 Insurance services

Economic importance. Figure 27 shows the relative stability of the insurance sector's weight in recent years, with GVA relative to GDP fluctuating between 0.7% and 0.8%. In 2022, **total GVA was EUR 120 billion**.

Figure 27. Insurance services Gross Value Added (% of EU GDP 2011 - 2022)



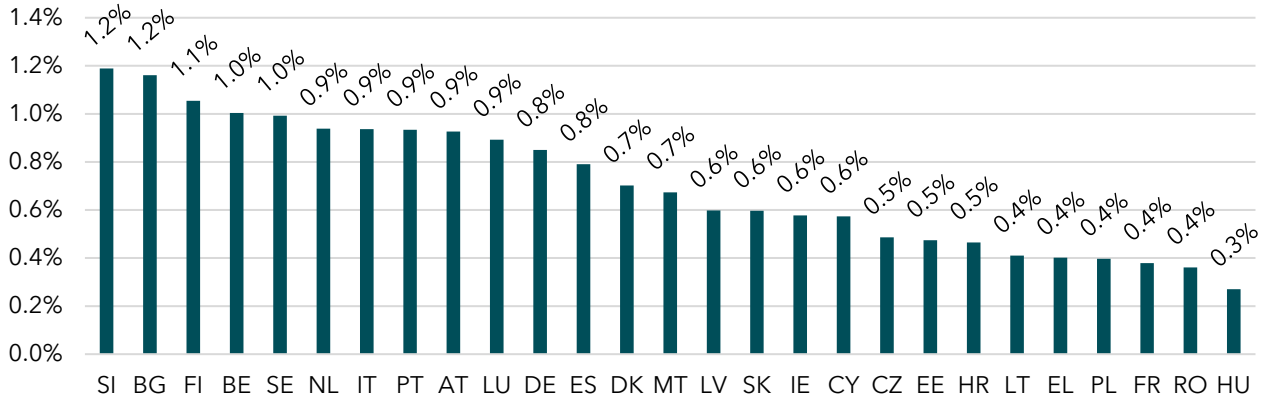
Source: Authors' elaboration based on Eurostat, National Account data[251]

Figure 28 below shows the variation across countries. The insurance sector is prominent in Member States including Slovenia, Bulgaria, Finland, Belgium, Sweden, the Netherlands, Italy and Portugal, reflecting a range of factors such as shifts following Brexit and the organisation of certain countries' pension systems. Other countries (e.g., Lithuania, Greece, Poland, France, Romania and Hungary) stand out for insurance sectors that are relatively small overall.

[250] For more granular data see Volume 2 - Annex 3.

[251] Eurostat, nama_10_gdp available at https://doi.org/10.2908/NAMA_10_GDP and nama_10_a64 available at https://doi.org/10.2908/NAMA_10_A64, (last accessed November 2025).

Figure 28. Gross value added of insurance services per Member State (% of GDP, 2022)



Source: Authors' elaboration based on Eurostat, National Account data[252]

Turnover. Turnover in the insurance sector can be defined as the gross premium earned, and for sub-sector K65.3 on pension funding, as the total pension contribution[253]. **Turnover for 2023 totalled EUR 1.2 trillion**, equal to 7.2% of EU GDP. A peculiarity of the insurance sector is that the figure includes both the income accruing to the industry and sums put aside to compensate for the occurrence of insured events (and investment components when it comes to certain life insurance policies); these elements are not integrated in SUT, which show a much lower figure of EUR 339.8 billion. The vast majority of turnover is generated by large firms and groups, with smaller firms only playing a niche role (namely in insurance intermediation, see detailed discussion below).

As shown in Table 17 in **2023, the insurance sector's net turnover as a share of GDP was highest in Luxembourg**, where EUR 23.3 billion accounted for 29.3% of GDP. France also recorded a significant share, with EUR 294.9 billion representing 10.4% of GDP[254], followed by Germany at EUR 374.4 billion (8.9% of GDP). Belgium, with EUR 47.6 billion making up 8.0% of GDP, Sweden (8.7%), and the Netherlands (7.4%) also demonstrated notable shares, reflecting the importance of insurance services in these countries. Moderate shares were seen in Italy, where EUR 150.0 billion accounted for 7.0% of the country's GDP, as well as in Spain with EUR 89.1 billion (5.9%) and Cyprus with EUR 1.7 billion (5.3%). Austria (4.9%), Estonia (4.2%), and Portugal (4.1%) also reflected mid-level shares of GDP. Lower shares were reported in Latvia, Malta, and Slovakia.

Table 17. Insurance industry net turnover (% GDP)

Member State	Net turnover (EUR bn, 2023)	% on GDP (2023)	Member State	Net turnover (EUR bn, 2023)	% on GDP (2023)
EU27	**1239.5**	**7.3%**	HU	4.8	2.5%
AT	23.2	4.9%	IE	16.4	3.2%
BE	47.6	8.0%	IT	150.0	7.0%

[252]Eurostat, nama_10_gdp available at https://doi.org/10.2908/NAMA_10_GDP and nama_10_a64 available at https://doi.org/10.2908/NAMA_10_A64, (last accessed November 2025).

[253] Commission Implementing Regulation (EU) 2020/1197 of 30 July 2020 laying down technical specifications and arrangements pursuant to Regulation (EU) 2019/2152 of the European Parliament and of the Council on European business statistics repealing 10 legal acts in the field of business statistics (Text with EEA relevance), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32020R1197.

[254] The difference between the low insurance sector GVA and high net turnover as a share of GDP in France may reflect several structural characteristics of the French market. A key factor is the predominance of the life insurance segment, which relies heavily on euro-denominated funds and unit-linked contracts. These products provide capital security but operate with relatively compressed margins. As a result, a lower GVA relative to turnover is structurally expected across the European insurance sector.

BG	4.2	4.4%	LT	2.1	2.8%
CY	1.7	5.3%	LU	23.3	29.3%
CZ	9.8	3.1%	LV	0.8	2.0%
DE	374.4	8.9%	MT	0.7	3.6%
DK	6.3	1.7%	NL	83.7	7.4%
EE	1.6	4.2%	PL	18.5	2.5%
EL	4.7	2.1%	PT	11.0	4.1%
ES	89.1	5.9%	RO	4.2	1.3%
FI	10.1	3.7%	SE	47.2	8.7%
FR	294.9	10.4%	SI	3.4	5.5%
HR	1.7	2.2%	SK	4.1	3.3%

Source: Authors' elaboration based on Eurostat, sbs_sc_ovw dataset[255]

Between 2021 and 2023, the net turnover of the EU insurance sector grew at a CAGR of 2.1%. The strongest growth was observed in Romania, with a remarkable 20.5% CAGR, followed by Lithuania at 17.3%, and Bulgaria at 16.3%. Greece (15.9%) and Cyprus (12.5%) also reported notable increases, alongside Latvia (13.5%) and Czechia (13.1%), reflecting expanding insurance activities in these countries.

Moderate growth rates were seen in Belgium (8.7%), Poland (6.4%), and Austria (5.0%). On the other hand, several countries experienced declines in net turnover during this period. Estonia (-27.7%) and Croatia (-27.0%) recorded the sharpest contractions, followed by Portugal (-14.4%) and Luxembourg (-10.1%). Ireland (-2.2%) and Italy (-2.4%) showed smaller declines, while Finland (-0.7%) and Sweden (-0.8%) experienced minimal decreases.

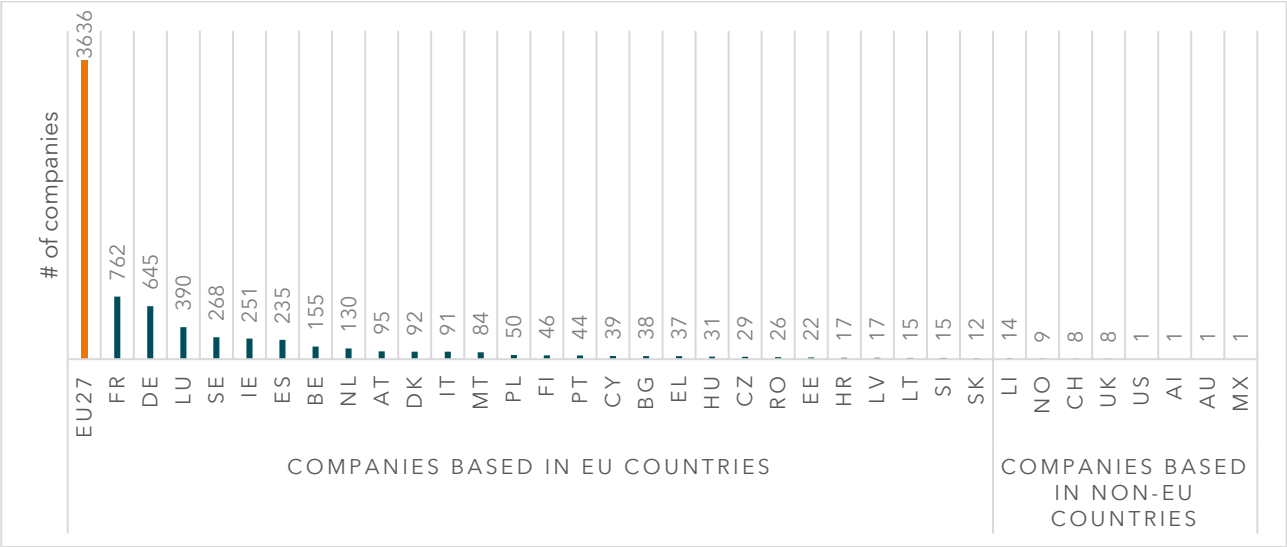
Number of companies. The main and most accurate source on the number of insurance undertakings is the EIOPA registry. This registry includes all the undertaking operating in Europe and allows for a further breakdown by the country of operation and the country where a company is located. An insurance company in Europe can:

- Be located in and operate in the same Member State. These are classified as domestic undertakings.
- Operate in a Member State while depending on a parent company located in another country: these are classified as branches, distinguished between EEA-branches and non-EEA branches on the basis of the country where the parental company is located.
- Operate under the Freedom to Provide Services (FPS): a company in a Member State can provide services to clients in other Member States without opening a local office. The large number of combinations (e.g., a company based in Italy providing services in seven other Member States would be counted eight times) leads to an overall figure of about **23,000 FPS cases** across the EU, which is much greater than the number of insurance undertakings as such.

Following this classification, EIOPA counts 3,679 companies operating in Europe, as branches or domestic undertakings. Figure 29 provides a breakdown based on where the company is located currently. The figure does not distinguish between branches and domestic undertakings.

[255]Eurostat, sbs_sc_ovw available at https://doi.org/10.2908/SBS_SC_OVW. (last accessed November 2025).

Figure 29. Number of insurance institutions operating in EU MS, by country of domicile (2023)

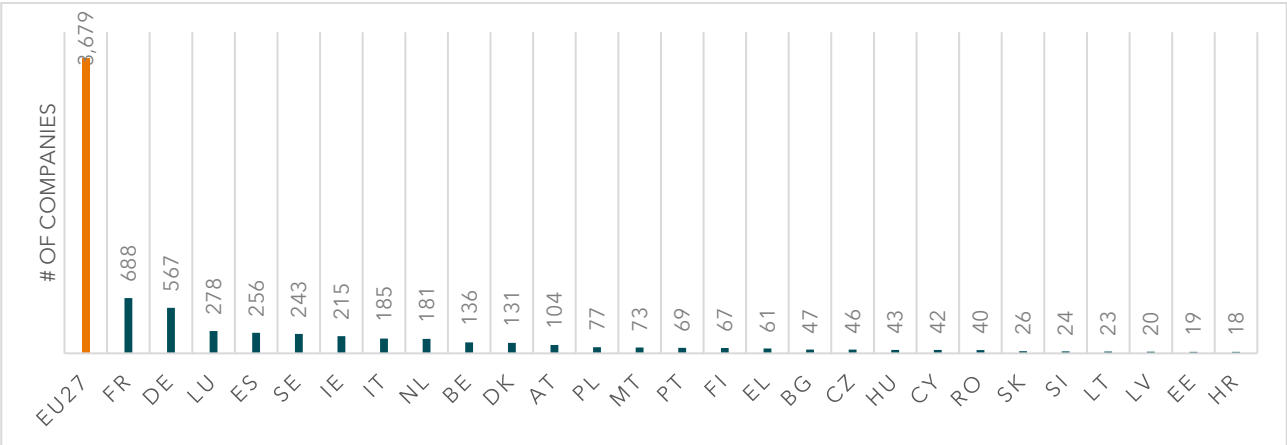


Source: EIOPA Registry of active undertakings, data from online repository[256]

The countries where the highest numbers of insurance companies active in the EU are based are France (762) and Germany (645). Other countries with a high number of undertakings are Spain (235), Luxembourg (390) and Sweden (268). For some other countries, number appears to be lower than expected, such as Italy (only 91). On the side of **extra-EU countries with insurance companies operating in the EU**, Liechtenstein (14) and Norway (9) have the highest number of undertakings.

Figure 30 offers the breakdown from another angle, namely for the country where a company is operating. In this case, the country with more operating undertakings is France (688), followed by Germany (527). Some countries, like Italy, show a stark difference between companies based in the country against the number of companies operating there (91 vs. 185). This suggests the existence of vibrant cross-border activities in the EU, with many companies exercising both the FPS and the Freedom of Establishment (FoE) to operate in several countries.

Figure 30. Number of insurance undertakings in EU MS, by country of operation (2023)



Source: EIOPA Registry of active undertakings, data from online repository

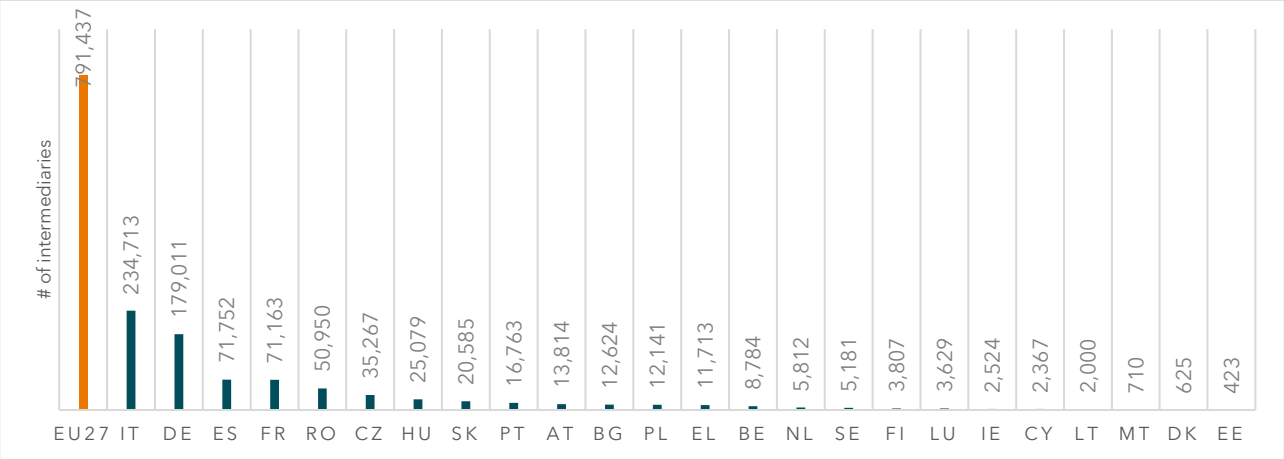
[256] EIOPA Online Registry of Active Undertakings, available at https://register.eiopa.europa.eu/ (last accessed November 2025).

Insurance intermediaries. While insurance undertakings may directly provide services to customers, an important role is also played by insurance intermediaries, such as agents and brokers. Unlike the rest of the sector, the market for insurance intermediation is characterised by a high prevalence of SMEs.

For **clients**, intermediaries help identify risks, ensure a constant flow of information, allow a better and more cost-effective process of selection of the best undertaking, and make the connection with insurers. For the **insurers themselves**, intermediaries may support the entrance on the market of new players, perform certain services insurance companies want to outsource and assist with claim-related services. Intermediaries can be roughly divided between agents and brokers. **Agents** are natural persons or companies working for one insurance company, providing a bridge between the undertaking and clients. **Brokers**, in contrast, are more independent and usually serve more companies at once, providing a role as facilitators in the establishing of new contracts.

There is no consolidated regulator data on insurance intermediaries, but the European Federation of Insurance Intermediaries **(BIPAR)** estimates that they represent around half of insurance contracts in Europe in terms of gross written premiums (GWPs). In terms of the number of intermediaries, BIPAR calculates in its latest report[257] (albeit without a high level of certainty) that there are nearly **800,000 intermediaries** in Europe (including the UK), with the breakdown by Member State shown in the table below. The picture differs significantly depending on how the insurance sector is arranged in a country. Italy and Germany show very large numbers of intermediaries, with high figures also in France and Spain, followed by Romania. The emergence of digital distribution models (Insurtech) is also likely to have profound effects on the intermediary market.

Figure 31. Number of insurance intermediaries, updated in July 2024



Source: BIPAR report on insurance intermediaries, UK excluded. Note: Number for HR, LV, SI not available.

Cross-border activity. As explained above, insurance companies can operate in other countries via the presence of subsidiaries or branches, under the terms of freedom of establishment (FoE), and / or by the Freedom to Provide Services (FPS), which entails supplying services directly from another country. As part of the picture, a total of **17 International Active Insurance Groups (IAIGs)[258]** operate in the EU. Cross-border data are available for branches and services provided cross-border, while services provided by subsidiaries cannot be distinguished in the data from those provided by domestic firms.

With this in mind, the EIOPA data show that **cross-border insurance activity in Europe accounted for EUR 104 billion in 2022 and circa 150 billion in 2023**, in terms of gross-written premiums (GWP) traded

[257] BIPAR, Figures on insurance intermediaries in Europe, update July 2024, retrievable at: BIPAR report-Figures_on_insurance_intermediaries-Update-July_2024.pdf (last accessed November 2025).

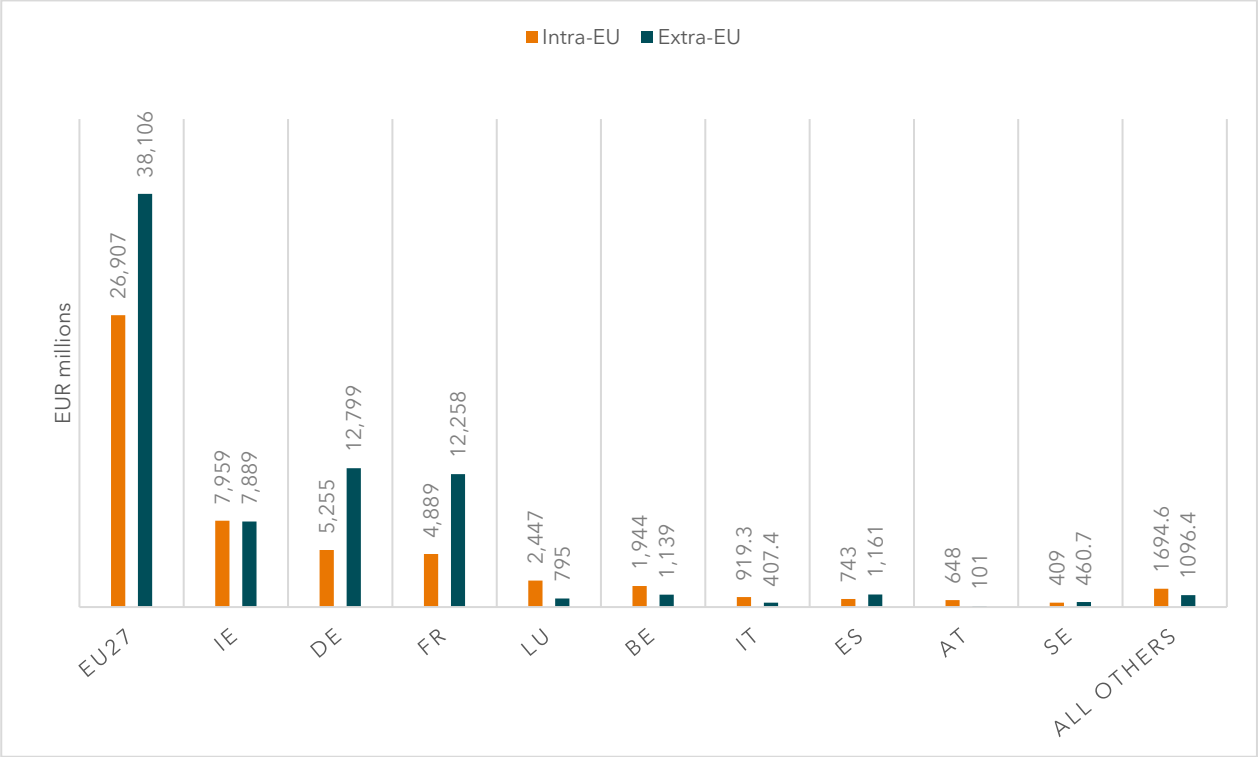
[258] EIOPA, List of IAGs headquartered in Europe. Available at: List of Internationally Active Insurance Groups (IAIGs) headquartered in the EU - EIOPA. (last accessed November 2025).

between Member States[259]. The 2023 figure breaks down between EUR 91 billion provided through FPS, and EUR 59 billion through FoE.

As concerns the home country of the insurance companies, **Luxembourg represents 27.8% of the share, and Ireland about 30%.** As receiving countries, **France and Italy cover respectively 19.9% and 22.1%** of the hosted branches and their business activities. Overall, crossing data from EIOPA and Eurostat, and adding a consideration about the **different sample size** (EIOPA data includes Liechtenstein and Norway, and the UK as receiver of services), the cross-border activities amount to approximately **10-12% of the turnover of this industry**.

On the side of exports, the EU totalled circa EUR 27 billion intra-EU credits and circa EUR 38 billion to third countries. The financial hubs of Ireland and Luxembourg are particularly prominent as exporters, as are Germany, France and Belgium. Imports EU totalled circa EUR 26 billion for intra-EU trade and about EUR 33 billion from third countries, with Ireland, France, Germany and Italy being especially prominent.

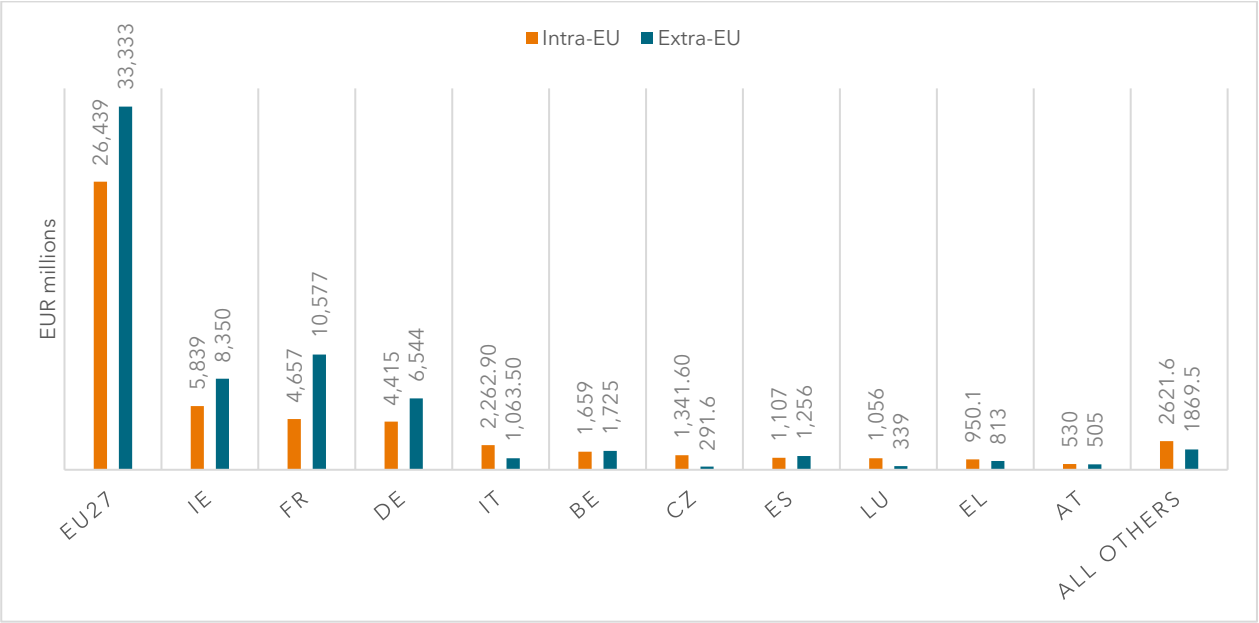
Figure 32. Export of insurance services, EUR millions (2023)



Source: Eurostat, Balance of Payments – BoP, Eurostat, reference year 2023. All values are in EUR million. Note: data for MT, NL and PL are confidential

[259] EIOPA Balance Sheet for Cross-Border activities.

Figure 33. Import of insurance services, EUR millions (2023)

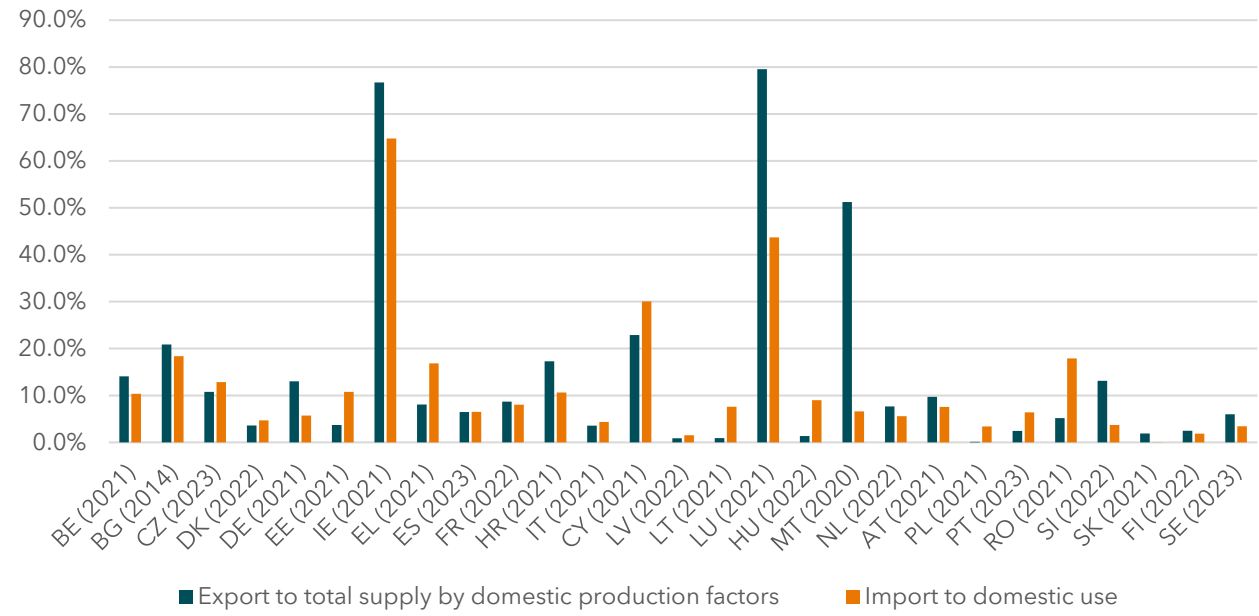


Source: Eurostat, Balance of Payments – BoP, Eurostat, reference year 2023.

As precedingly done for the banking services, we can put exports and imports of financial services into perspective, calculating and comparing the ratio of imports—covering both extra- and intra-EU flows—to total domestic use, and the ratio of exports—also including extra- and intra-EU transactions—to total supply generated by domestic production factors for the relevant services.

For insurance services (CPA 65), the median export-to-total-supply ratio and the median import-to-domestic-use ratio were almost identical, each standing at 7.6%. As with banking services, the two ratios are strongly correlated: Member States with a higher share of imports also tend to display a greater degree of export orientation. The highest values were recorded for Ireland, with export and import ratios of 76.7% and 64.8% respectively, followed by Luxembourg at 79.6% and 43.7%, and Malta at 51.2% and 6.6%.

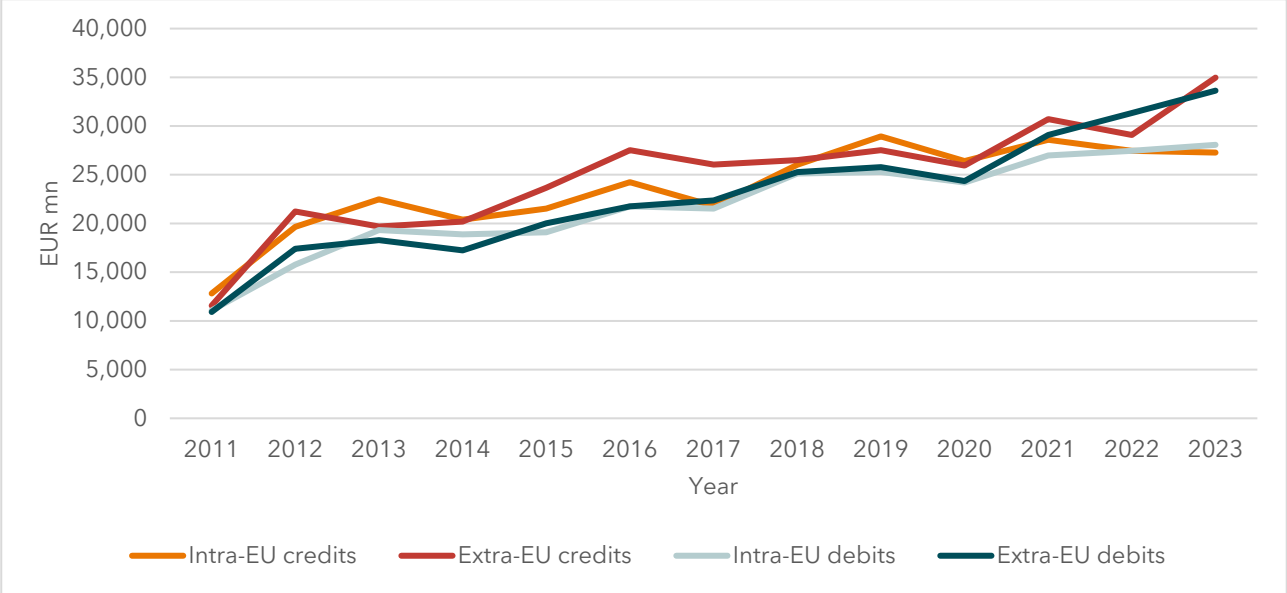
Figure 34. Relative importance of export and imports of insurance services (CPA65)



Source: Eurostat (naio_10_cp15 and naio_10_cp16)

As with banking, the historical trend in insurance has been for more international trade over time, as shown in Figure 35.

Figure 35. Insurance services intra-EU and extra-EU debits and credits at EU-27 level (adjusted for inflation)



Source: Eurostat, Balance of Payments – BoP, Eurostat, reference year 2023. All values are in EUR million

Profitability and cost-structure. To analyse this aspect, it is important to note the difference between turnover measured as the sum of the gross written premiums and a net measure of turnover. This is due to the presence of "claims incurred", which is a measure of the claims which are paid out, and which must be taken out of the account of the gross written premiums to arrive at a meaningful figure. According to EIOPA, these claims represent 67.2% of the total of premiums written in the EEA in 2023 for the non-life sector, and 96.9% of the same ratio, in the life sector[260].

For the life sector, total costs represented 28.5% of the gross written premiums, while for **non-life sector they represented 12.5%**. Compared to the previous study based on 2018 data, the ratio of expenses and premiums in both non-life and life sector has been consistent. Concerning the structure of the costs of the sector, the elements considered are: (i) administrative expenses; (ii) investment management expenses; (iii) claims management expenses; (iv) acquisition expenses; (v) overhead expenses and (vi) other expenses (Table 18).

Table 18. EU Cost-structure for insurances

Cost type	Life	Non-life	Total
Administrative	19.8%	26.4%	22.0%
Investment	1.2%	9.6%	4.0%
Claims	17.7%	6.8%	14.1%
Acquisition	49.3%	48.2%	49.0%
Overhead	10.6%	10.7%	10.6%
Total as a share of Premiums Written	*28.5%*	*12.5%*	*23.1%*

Source: EIOPA data, Insurance statistics and balance sheet. Note: The total is the average of the life and non-life segments, as proportion of the gross written premiums.

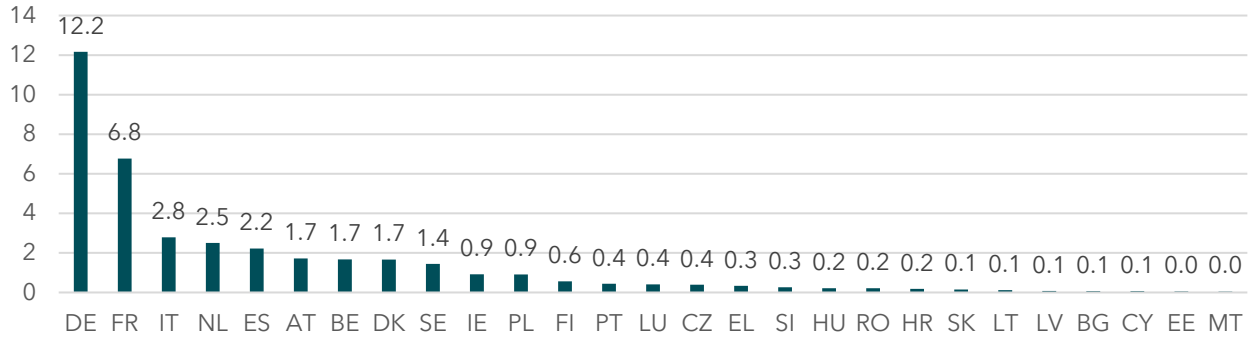
[260] EIOPA, Statistics on Premiums, Claims and Expenses, owns' author calculation on EIOPA data.

According to a 2024 EIOPA report on sectoral spending on digitalisation in the EU, undertakings are currently allocating an average of approximately 8% of their Gross Written Premiums (GWPs) towards supporting their digital transformation strategies. This investment proportion is anticipated to remain stable over a three-year outlook. Almost 80% of respondents if the EIOPA survey outsource cloud computing data storage to BigTech cloud services. This outsourcing of cloud computing storage services represents the main commercial relationship held with BigTechs, followed by communication tools and data analytics services. Most insurance undertakings anticipate a significant or moderate increase in outsourcing services from BigTechs in the next three years[261].

Concerning the cost of labour, in 2022 **total remuneration[262] in insurance services was EUR 38.4 billion**, reflecting the aggregate labour cost incurred by employers, including gross wages and salaries paid in cash or in kind, as well as social contributions to statutory and private social insurance schemes.

As shown in Figure 36, **remuneration has largely tracked the size of different countries' insurance industries**. The highest remuneration was seen in Germany, with over EUR 12 billion, followed by France (EUR 6 billion). Italy, the Netherlands and Spain, Austria, Belgium and Denmark reported moderate remuneration of around EUR 3 billion each, while most other countries showed about EUR 1 billion each.

Figure 36. Employee remuneration in the insurance sector across EU Member States (EUR bn, 2022)



Source: Eurostat, nama_10_a64 dataset[263]

Between 2016 and 2022, CAGR for employee remuneration in insurance services for the EU averaged 1.9%. Lithuania experienced the highest growth with a 12.6% CAGR, followed by Latvia at 8.2% and Malta at 7.9%. Greece, Estonia and Romania also exhibited notable growth rates, ranging from 6.6% to 7.4%. Conversely, countries like Ireland (-1.7%), Spain (-1.6%), and the Netherlands (-1.2%) experienced declines in employee remuneration during this period. Countries as Germany, France, and Italy recorded modest growth rates of 1.6%, 3.6%, and 1.4%, respectively.

Customer base. At the EU level **in 2022, households were the main insurance services consumers** (62.1%), followed by businesses (35.0%) and the public sector (2.9%). All segments grew steadily since 2018, with B2B rising 4.8%, B2C 2.1%, and B2G 8.3%. Germany, France, Italy, and Ireland led B2B spending, while Spain and the Netherlands also saw high volumes. In B2C, France and Germany dominated, with Italy also notable. For B2G, Germany, France, and Italy topped public sector spending, followed by Ireland and Spain. The highest B2B growth occurred in Romania, Malta, and Portugal. B2C grew most in Malta, Bulgaria, and Poland. B2G spending surged in Slovakia, Ireland, and Malta. Latvia saw the sharpest drop (-17.2%), with other declines in Belgium, Estonia, France, and Italy[264].

[261] EIOPA, Report on the digitalisation of the European insurance sector (2024) retrievable at EIOPA's Report on the digitalisation of the European insurance sector - EIOPA. (last accessed November 2025).

[262] EU27 (as far as from 2020), indicator D11, aggregates by geographical unit [*nama_10_a64*].

[263] Eurostat, nama_10_a64 available at https://doi.org/10.2908/NAMA_10_A64 (last accessed November 2025).

[264] For more granular data see Volume 2 - Annex 3.

Table 19. Customer base for insurance services, supply and use tables (EU 27)

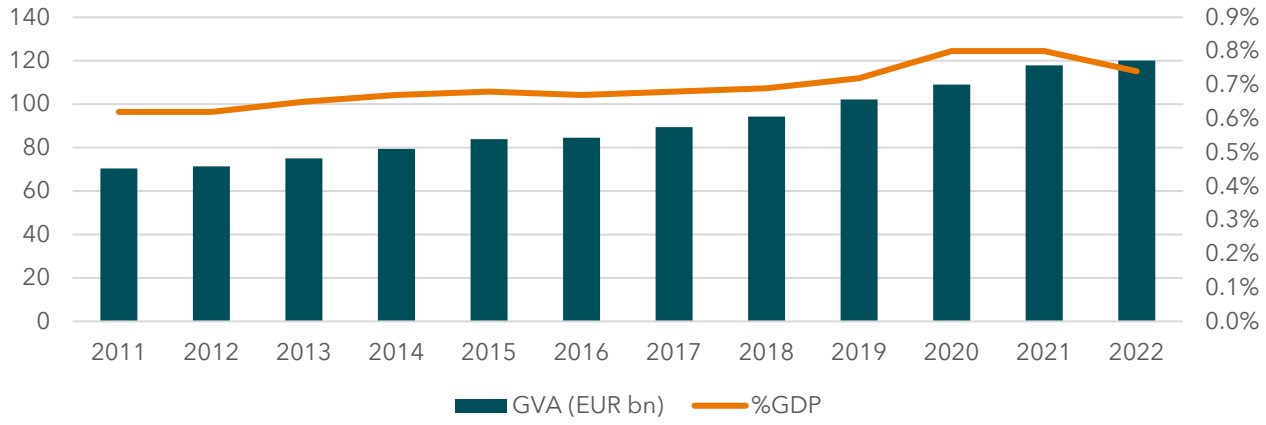
Market segment	Consumption in 2018 (EUR million)	Consumption in 2022 (EUR million)	% of consumption in 2022	CAGR of consumption (2018-2022)
B2B	88199.6	106467.4	35%	4.80%
B2C	173650.9	188707.8	62.10%	2.10%
B2G	6388.3	8785.2	2.90%	8.30%

Source: Eurostat, FIGARO - EU Inter-Country Use Tables (EU IC-SUIOTs)

4.5 Other financial services (i.e., investment services)

Economic importance. Figure 37 shows that the GVA[265] of other financial services has risen over time, reaching its highest level in 2022. Similarly, the GVA to EU GDP[266] ratio has shown a gradual increase over the same period, peaking at approximately 0.8% in 2021 before a slight decline in 2022.

Figure 37. Gross Value Added in investment services (% of EU GDP 2011 - 2022)



Source: Authors' elaboration based on Eurostat, National Account data[267]

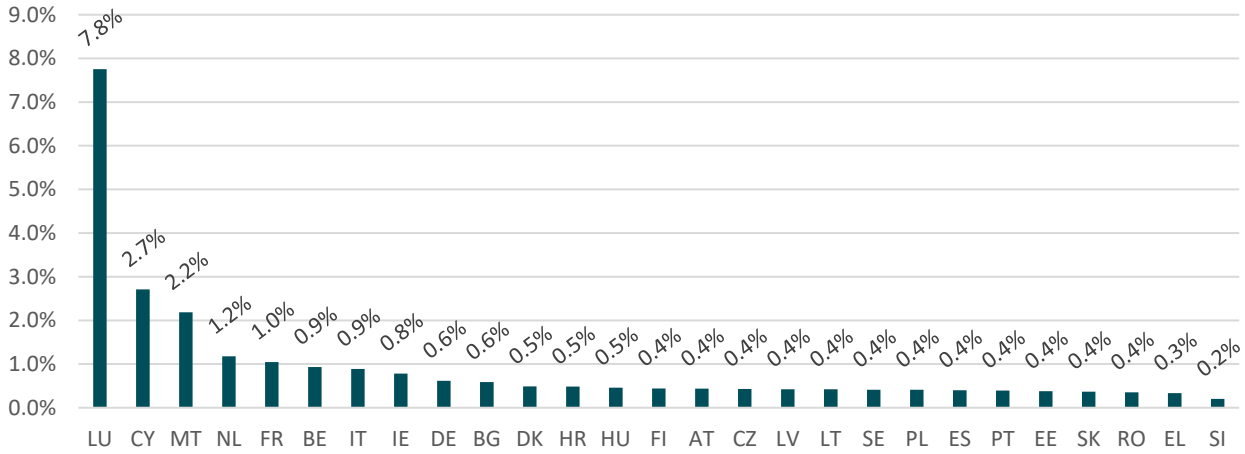
Looking at **Member State level** (Figure 38), **the GVA to GDP ratios reveal striking disparities across the EU**. Luxembourg again emerges as a hub, with an exceptionally high GVA/GDP ratio over 8%. Cyprus and Malta also stand out again, with ratios exceeding 2%, highlighting their specialised focus on fund management. For other Member States the ratios are much lower, typically below 1%.

[265] EU27 (as far as from 2020), current prices in millions of Euros. Eurostat's National Accounts aggregates by geographical unit [*nama_10_gdp*].

[266] Eurostat's National Accounts aggregates by industry [*nama_10_a64*]. EU27 (as far as from 2020), current prices.

[267] Eurostat, nama_10_gdp available at https://doi.org/10.2908/NAMA_10_GDP and nama_10_a64 available at https://doi.org/10.2908/NAMA_10_A64 (last accessed November 2025).

Figure 38. Gross value added of investment services per Member State (% of GDP, 2022)



Source: Authors' elaboration based on Eurostat, National Account data[268]

Considering **fund management**, an important distinction is between the domiciliation of an investment fund and the ownership of a fund itself. The *domiciliation* is the location of the fund in legal, regulatory and administrative terms, while *ownership* refers to the possession of shares of the funds, and *management* to where the managerial entity is located. Table 20 provides a breakdown of funds in the EU for these three aspects, in terms of the funds included in EFAMA's analysis. The table also shows fund ownership and management as a proportion of those domiciliated in each country. These ratios are relevant because they allow to observe how countries tend to specialise their investment services, if there are more investors possessing funds or managing them.

Table 20. Investment funds by country of domiciliation, ownership and management of the funds (2023)

Country	Funds by domicile (EUR bn)		Funds by ownership (EUR bn)		Funds by management (EUR bn)		Ratio managed over domiciliated	Ratio owned over domiciliated
EU	**20,686**	**100%**	**18,398**	**100%**	**17,095**	**100%**		**89%**
FR	2,277	11%	2,082	11%	3,160	19%	*139%*	*91%*
DE	2,653	13%	3,699	20%	2,414	14%	*91%*	*139%*
NL	826	4%	1,124	6%	826	5%	*100%*	*136%*
IT	373	2%	1,251	7%	520	3%	*139%*	*335%*
ES	364	2%	700	4%	388	2%	*107%*	*192%*
DK	275	1%	377	2%	313	2%	*114%*	*137%*
BE	202	1%	511	3%	235	1%	*116%*	*253%*
AT	211	1%	293	2%	188	1%	*89%*	*139%*
PL	74	0.40%	64	0.30%	74	0%	*100%*	*86%*
HU	37	0.20%	55	0.30%	37	0%	*100%*	*149%*
TR	68	0.30%	42	0.20%	35	0%	*51%*	*62%*
PT	33	0.20%	72	0.40%	26	0%	*79%*	*218%*
CZ	27	0.10%	65	0.40%	24	0%	*89%*	*241%*
EL	19	0.10%	23	0.10%	14	0%	*74%*	*121%*

[268]Eurostat, nama_10_gdp available at https://doi.org/10.2908/NAMA_10_GDP_and_nama_10_a64 available at https://doi.org/10.2908/NAMA_10_A64 (last accessed November 2025).

SK	10	<0.1%	27	0.10%	10	0%	*100%*	*270%*
SI	5	<0.1%	9	<0.1%	5	<0.1%	*100%*	*180%*
HR	3	<0.1%	6	<0.1%	4	<0.1%	*133%*	*200%*
CY	6	<0.1%	10	0.10%	3	<0.1%	*50%*	*167%*
BG	1	<0.1%	5	<0.1%	1	<0.1%	*100%*	*500%*
FI	149	1%	338	2%				*227%*
IE	4,083	20%	866	5%				*21%*
LU	5,285	26%	1,340	7%				*25%*
MT	20	0.10%	14	0.10%				*70%*
RO	7	<0.1%	8	<0.1%				*114%*
SE	585	3%	772	4%				*132%*
Non-EU					**2,098**	**12%**		
UK	1,909	9%	2,519	14%	4,759	*28%*	*249%*	*132%*
CH	883	4%	1,918	10%	1,961	12%	*222%*	*217%*
LI	127	1%	n.a.	n.a.				
NO	173	1%	208	1%				*120%*

Source: EFAMA, Asset management in Europe: an overview of the asset management industry, December 2024. Net asset in EUR bn.

Note: Funds' domicile, ownership and management are always presented in terms of asset, in billion euros, and shares over the total Europe (not only EU) count. The ratios are calculated only for the country with the specific data present and in terms of asset percentages.

As major hubs for the fund industry, Luxembourg and Ireland stand out in this respect, *hosting* a significant share of funds (circa 26% and 20%, respectively), while only *owning* 7% and 5%, In contrast, *ownership* is concentrated in larger countries such as France, Germany, the Netherlands and Italy. Certain countries are also prominent in fund *management*, such as France, Italy, and – outside the EU – Switzerland. The reasons some countries have become hubs for funds may have originated with favourable regulatory and tax regimes, but it continues due to other factors like the presence of skilled workers, infrastructure and cluster effects.

Turnover. Turnover in investment services is defined as the difference between gross fees received and those paid by the funds. Net turnover in 2023 according to SBS totalled some **EUR 220 billion**. As a comparison, a higher figure of EUR 277.6 billion was available from SUT. It is also worth noting that the previous study, using supervisory registers and data from sectoral federations, arrived at a much higher figure of EUR 800 billion for 2017, though this likely overlapped partly with the turnover of insurance and banking, since firms from these industries control a large share of asset managers in some countries.

As shown in Table 21, in 2023, **Luxembourg stood out with the highest turnover as a share of GDP**, at 38.8%. **Cyprus followed with 11.2% of GDP**. Poland had a share of 3.0%, and Belgium had a share of 3.5%. France recorded the highest absolute turnover among larger economies at EUR 71.7 billion, contributing 2.5% to GDP.

Table 21. Investment services net turnover in absolute values (EUR bn) and % GDP in EU Member States

Member State	Net turnover (EUR bn, 2023)	% on GDP (2023)	Member State	Net turnover (EUR bn, 2023)	% on GDP (2023)
EU27	**309.1**	**1.8%**	HU	2.9	1.5%
AT	5.8	1.2%	IE	10.7	2.1%
BE	21.0	3.5%	IT	27.9	1.3%

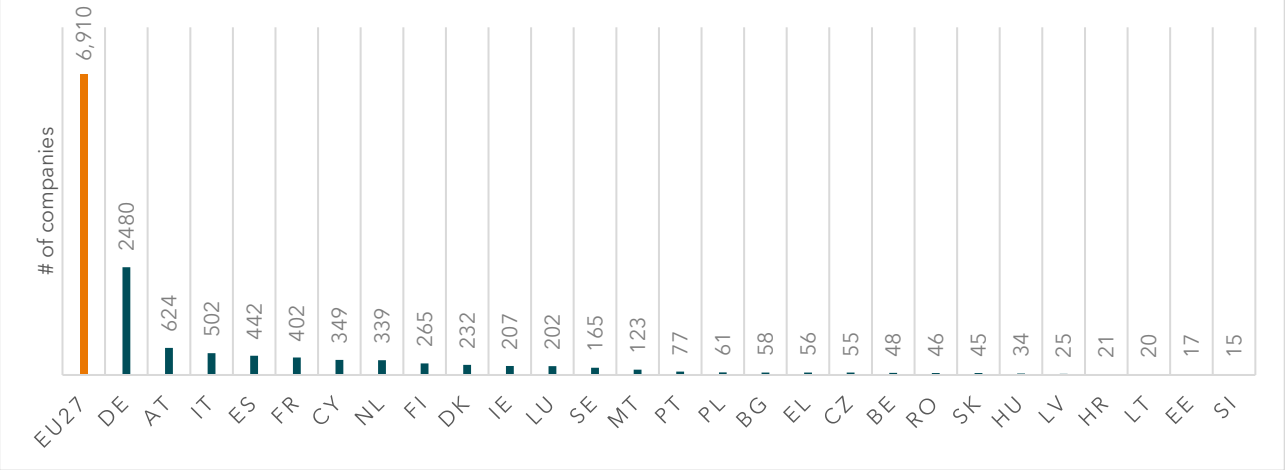
BG	0.7	0.8%	LT	0.9	1.2%
CY	3.6	11.2%	LU	30.8	38.8%
CZ	4.3	1.4%	LV	0.3	0.8 %
DE	54.2	1.3%	MT	1.2	6.0%
DK	3.0	0.8%	NL	11.3	1.1%
EE	0.2	0.5%	PL	22.5	3.0%
EL	1.6	0.7%	PT	2.0	0.7%
ES	14.1	0.9%	RO	1.3	0.4%
FI	5.1	1.9%	SE	9.9	1.8%
FR	71.7	2.5%	SI	0.3	0.5%
HR	0.6	0.8%	SK	0.9	0.7%

Source: Authors' elaboration based on Eurostat, sbs_sc_ovw dataset[269]

Between 2021 and 2023, the net turnover of this sector grew at a CAGR of 2.1%. Bulgaria recorded the highest growth, with a CAGR of 23.2%, followed by Spain (16.9%), Belgium (16.6%), and Greece (14.1%). Latvia also showed strong growth at 14.8%, while France (10.7%) and Slovenia (11.0%) demonstrated steady increases. Moderate growth was observed in Austria (7.5%), Poland (7.2%), and Croatia (7.2%). Countries like Luxembourg (2.4%) and Finland (2.0%) reported more modest growth rates. In contrast, declines were recorded in Ireland (-14.0%), Sweden (-12.1%), and Malta (-9.1%), while Germany (-8.9%) and Czechia (-8.0%) also experienced contractions.

Number of companies. ESMA reports 6,910 investment firms operating in the EU as of 2024. A large proportion are in Germany (2,489), while relatively large numbers are also found in Italy (502), France (402). This is in line with the possession and management of the funds, as explored in the above dedicated paragraph, where these three countries represented hubs for these functions in the investment sector.

Figure 39. Number of investment firms operating in EU Member States (2024)



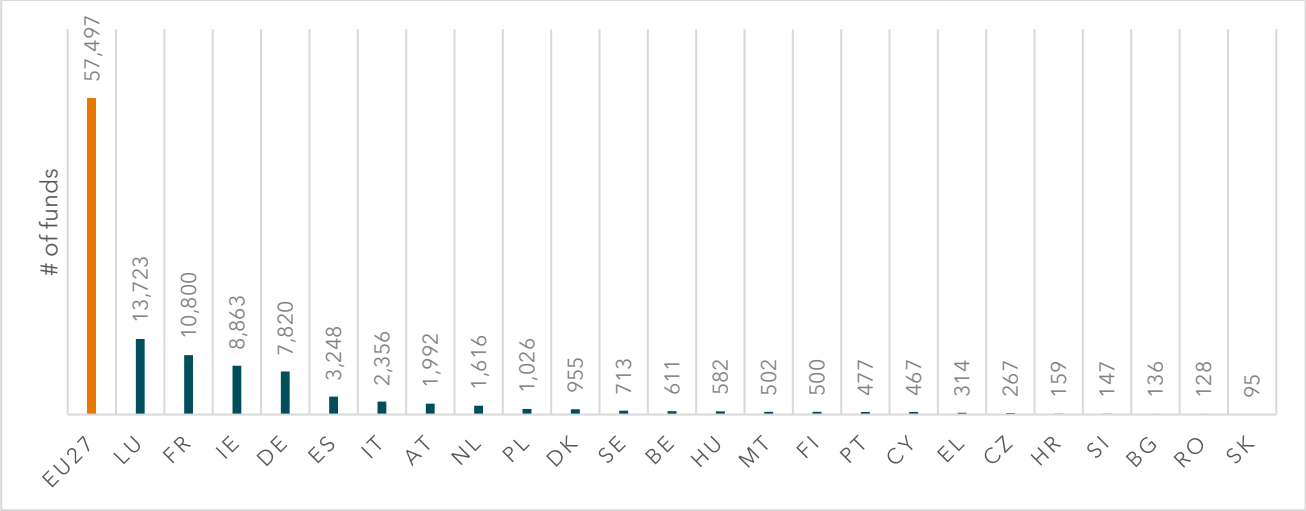
Source: ESMA, online registry[270]*, selected only the "Investment Firms"*

[269] Eurostat, sbs_sc_ovw, available at https://doi.org/10.2908/SBS_SC_OVW (last accessed November 2025).

[270] ESMA, Online Investment Firm Registry, available at: https://registers.esma.europa.eu/publication/searchRegister?core=esma_registers_upreg (last accessed November 2025).

Regarding the number of funds (both UCITS and AFIs) active in each Member State, in line with the preceding finding on the domiciliation of the funds, large numbers are found **in Luxembourg (13,723) and Ireland (8,863)**. As explained, the location of the funds does not depend on the location of the companies nor with the legal possession of such assets. Funds can be located in a certain country – e.g., Ireland – and managed and owned from abroad for a variety of reasons, including fiscal considerations as well as historical factors leading to a strong workforce and cluster effects.[271]

Figure 40. Number of active funds in each Member State (2024)



Source: EFAMA Quarterly Statistics, December 2024, n. 99
Note: data for EE, LT and LV unavailable.

Cross-border activity. While reporting the cross-border activities of the other financial services, it is important to define a difference between the Asset under Management (AuM) point of view, which is the one of management companies of funds, and the perspective in terms of funds, their location, the ownership and the management itself of the assets.

In 2023, **domestic clients made up 67.4% of AuM, down from 70.3% in 2019**. This analysis covers the EU27 and the United Kingdom, as included in EFAMA reports. That said, the trend shows an increase in foreign clients for European asset managers, with assets managed for foreign clients rising by 11.4%, compared to a 3.7% rise in domestic client assets.

The situation is different from the perspective of funds. UCITS funds can be sold both domestically (in the same country they are domiciliated) and cross-border (in other countries). In 2023, **fewer funds were marketed domestically in the EU compared to cross-border ones**. The net assets of international cross-border funds amounted to **EUR 11 trillion in 2023**, against the **EUR 8.6 trillion of domestic funds**. Only EUR 6 trillion of these assets are maintained outside of the EU, with the large majority instead being located at the domestic level[272].

Broken down between UCITS and AIFs, **67.8% of UCITS funds were sold cross-border**, against only the **18.1% of AIFs funds**. At national level, **two countries alone encompass the 98% of all the non-domestic market in EU: Ireland and Luxembourg** – respectively EUR 4.8 and 5.5 trillion of cross-border UCITS assets. For most other EU countries, on average over the 90% of the funds are traded domestically[273]. Other **countries that perform hub roles are Malta, Latvia and Cyprus** (which fund assets were sold respectively the 84%, 49% and 41% cross-border). In other words, the fund market is essentially intra-EU. However, there

[271] See also Rakowski, D. (2023). Disentangling domiciles and investor locations in European mutual fund data. *Financial Research Letters*. Vol. 52. DOI: https://doi.org/10.1016/j.frl.2022.103390.

[272] EFAMA (2024), *Factbook 2024 – General Overview*. Available at: https://www.efama.org/sites/default/files/files/brochure-efama-fb-2024_final.pdf (last accessed November 2025).

[273] *Ibidem*.

is some possible change on the horizon: in 2023, extra-EU fund assets surpassed intra-EU fund assets (EUR 6 trillion against EUR 5.1 trillion) for the first time.

Profitability and cost-structure. This section outlines both how funds and the investment management firms are reporting costs and profits. On the side of investment firms, this considers company performance and the impacts on this of key costs. For funds, the focus is on performance, meaning how, in average, funds are able to generate a positive – or negative – return on the investment for managers and investors.

In 2023, the **operating profit margin in the asset management industry declined to 11.1 basis points of average Asset under Management (AuM)** - after having peaked in 2021 at 15.1 - the lowest since 2009[274]. This drop was due to stable revenue but rising costs from 2022 to 2023. Passive fixed income is expected to grow at a CAGR of 11% by 2028, driven by declining fund fees, increased fee transparency, and growing competition from passive management. Asset manager costs rose until 2021, peaking at EUR 34.6 billion, but have since stabilised at EUR 33.8 billion in 2023 due to reduced distribution costs and the rise of online platforms. For funds, ESMA reports the net performance of UCITS (equity, bond and mixed) was 1.5% in 2023. Equity UCITS performed better at 3.1%. There is also a distinction to be pointed out between active and passive funds and ETF.

Table 22. UCITS net performance by management type, in percentage point

Year	Type	Active fund	Passive fund	ETFs
2019	**Equity UCITS**	9.2	11.8	11.7
	Bond UCITS			
2020	**Equity UCITS**	-0.4	-0.7	-2.2
	Bond UCITS			
2021	**Equity UCITS**	30.1	32.2	31.7
	Bond UCITS	4.7	3.9	2.1
2022	**Equity UCITS**	-10.6	-7.2	-4.8
	Bond UCITS	-7.4	-10.6	-6.0
2023	**Equity UCITS**	3.4	7.2	7.6
	Bond UCITS	-1.1	-1.0	-1.3

Source: ESMA Market Report on Cost and Performance of EU Retail investment products, 2024. Performance for bonds in 2019 and 2020 not available

Passive funds performed better than other categories, in particular passive equity UCITS – 32.2% against 3.9% of bonds. The poor performance of 2020 funds are easily explained by the uncertainty provoked by the Covid-19 pandemic, while performance in 2021 was a standout year. One of the reasons for such top performance is "*the global surge in central bank liquidity and fiscal support since the depths of the pandemic in early 2020, with revenue growth outpacing the persistent growth in costs*"[275].

Another stark distinction can be noticed, for both costs and performance, considering the difference between **ESG and non-ESG funds**.[276] ESG funds have shown better performance if compared to non-ESG funds (2.3% for all the funds, and 4.0% for the equity ones). For ETFs, the performance of **ESG UCITS** in

[274] EFAMA (2024), *Asset Management in Europe 2024*. Available at: https://www.efama.org/sites/default/files/files/asset-management-report-2024.pdf (last accessed November 2025).

[275]Edelmann, C., Zwick, J., Kaczmarski, K., Wuergler, T., Rodrigues, J. M., Burkl, M., Sachtleben, L., & Scheuber, K. (2022, June). How wealth and asset managers can win: Wealth management 3.0. Oliver Wyman. Available at : https://www.oliverwyman.com/our-expertise/insights/2022/jun/morgan-stanley-oliver-wyman-wealth-asset-management-report-2022.html (last accessed November 2025) p. 10.

[276] ESMA relies on the definition of Morningstar for defining what is a ESG funds, namely UCITS which, for regulatory reasons, are classified as Article 9 (having sustainability objectives) or Article 8 (promoting sustainable characteristics).

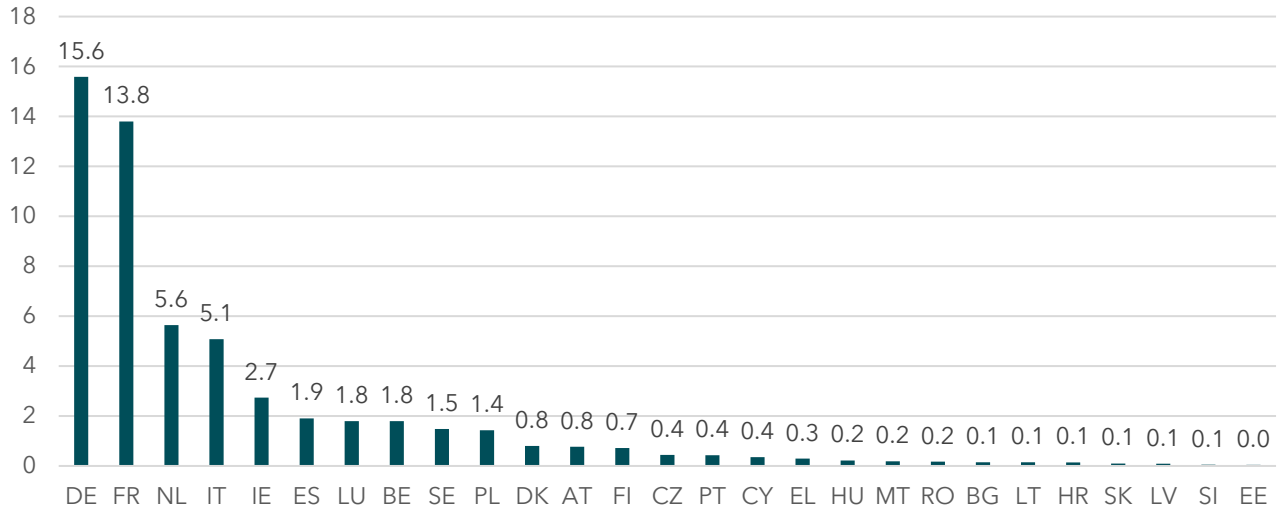
2021 was 32.8% compared to 8.6% for non-ESG UCITS. Bonds had a net performance of 3.6% compared to -0.2%, and ETFs of ESG UCITS had a net performance of 31.8% compared to 10.3% for UCITS.

Still considering the costs of funds, **EU aggregated fund costs have been on a downward trend through 2021**. Generally, the total costs of domestic UCITS have been lower than those of cross-border UCITS, despite the latter having a larger share of total assets available. For ESG UCITS funds, costs have been lower than for non-ESG funds.

A key cost issue concerns **costs for technology and operations, which have steadily increased in the last years**. These costs have risen due to heightened investment in technologies such as software, hardware, and data, which are necessary for asset managers to remain competitive. For example, the costs of application development have nearly doubled since 2019, from EUR 1.6 billion to EUR 2.5 billion, and investment in market data has also doubled, **from EUR 400 to EUR 900 million**[277].

Other costs include the remuneration of employees. In 2022, **total remuneration**[278] **was EUR 56.3 billion**, reflecting the aggregate labour cost incurred by employers, including gross wages and salaries paid in cash or in kind, as well as employer social contributions to statutory and private social insurance schemes and other charges.

Figure 41. Employee remuneration in investment services across EU Member States (EUR bn, 2022)



Source: Authors' elaboration based on Eurostat, nama_10_a64 dataset [279]

In 2022, total **employee remuneration varied significantly among the EU Member States in line with the size of the industries in the different countries**. Germany reported the highest amount (almost EUR 16 billion), followed by France (almost EUR 14 billion) and the Netherlands (almost EUR 6 billion). Italy and Ireland followed, with employees' remuneration around, respectively, EUR 5 and EUR 3 billion.

Between 2016 and 2022, **CAGR of remuneration averaged 6.3%.** Lithuania showed the highest growth, with a CAGR of 25.7%, followed by Romania at 15.2% and Malta at 13.2%. Other notable increases were observed in Bulgaria (12.7%), Cyprus (12.9%), and Czechia (11.3%). In contrast, countries such as Italy (2.6%), Croatia (2.8%), and Denmark (2.1%) experienced more modest growth rates. Germany, France, and Spain showed increases of 4.8%, 8.8%, and 7.9%, respectively.

Customer base. Unlike for the banking and insurance sectors, in asset management the sectoral federation publishes data that can be used to approximate the customer base by market segment. This is shown in the

[277] EFAMA (2024), *Asset Management Report 2024*, p. 60.

[278] EU27 (as far as from 2020), indicator D11, aggregates by geographical unit [*nama_10_a64*].

[279] Eurostat, nama_10_a64, available at https://doi.org/10.2908/NAMA_10_A64 (last accessed November 2025).

Table 23 below, which shows households as directly owning around a quarter of funds, while governments hold 3% and the remaining investors falling into the B2B segment.

Table 23. Investment funds by client type (2023, share of assets under management)

Client type	Assets under management
Households (B2C)	24%
Government (B2G)	3%
Business (B2B)	73%
Insurers and pension funds	*38%*
Monetary financial institutions	*3%*
Other financial intermediaries	*26%*
Non-financial corporations	*6%*

Source: EFAMA, Quarterly Statistical Release, March 2024 N°96

According to Eurostat supply and use tables, investment services in the EU were heavily B2B-focused in 2022, with businesses accounting for 90.5% of total spending (EUR 257.6 billion). B2C and B2G segments were much smaller, at 8.8% (EUR 25.1 billion) and 0.7% (EUR 2.0 billion), respectively.

Top B2B spenders included France, Germany, Luxembourg, and Italy. B2C spending was highest in Spain, Poland, and Italy, while B2G spending was led by Spain, the Netherlands, and France. B2B growth was strongest in Lithuania, Romania, and Cyprus. B2C growth was highest in Lithuania, Estonia, and Cyprus. B2G spending grew most in Cyprus, Romania, and Czechia but declined more widely than in banking or insurance. Hungary saw a complete cut in B2G spending, with notable drops also in Ireland, Luxembourg, and Italy.

Table 24. Customer base for other financial services, supply and use tables (EU 27)

Market segment	Consumption in 2018 (EUR million)	Consumption in 2022 (EUR million)	% of consumption in 2022	CAGR of consumption (2018-2022)
B2B	206473.5	257622.2	90.50%	5.70%
B2C	22232.3	25080.7	8.80%	3.10%
B2G	1773.3	1995.2	0.70%	3.00%

4.6 Summary of key findings

The sectoral analysis shows that **the broad contours of the financial sector have remained stable in recent years**, though key trends – particularly digitalisation – are leading to an increasingly important role for niche players and a diversifying product mix.

In terms of **economic importance**, financial services represent a significant share of economic activity in the EU, accounting for EUR 700 billion of GVA and 4.2% of EU GDP in 2023. This has been relatively stable over time, with a small recent gradual decline. Just under two thirds of the added value is generated by the banking sector, while insurance and other financial services account for about one sixth each. The financial sector also holds about EUR 85,000 billion of assets, worth over 500% of GDP. Nonetheless, all three sectors have demonstrated steady growth in absolute terms, underscoring the continued economic importance.

The **financial sector is especially prevalent in Luxembourg**, a financial hub where it represents nearly a quarter of GDP (i.e., five times the EU average). Other hubs include Cyprus and Malta, and for certain subsectors, countries like Ireland (in fund management) and the Netherlands. In contrast, the financial

sector plays a relatively smaller role in large, diverse economies like France and Germany, despite being important in absolute terms, as well as a number of countries in Central and Eastern Europe.

The financial sector is also a major source of **employment** in the EU. Almost five million people are employed in these industries, accounting for 2.3% of all employment, a figure that has been relatively stable over time. Of these, slightly more than half (54%) are employed in banking, with 17% in insurance and 29% in other financial services.

Turnover has been assessed preliminarily using SBS. The analysis shows banking turnover of just over EUR 900 billion, insurance turnover of EUR 1,240 billion, and EUR 220 billion for other financial services. In relative terms, all three subsectors are especially important in Luxembourg, while for other countries the situation differs by subsector. Banking and other financial services tend to dominate in hub countries, while insurance is especially important in large economies including France and Germany as well as Belgium, Sweden and the Netherlands. In terms of the **number of companies**, regulator data shows just under 5,000 credit institutions in the EU, just under 4,000 insurance undertakings, and nearly 7,000 investment firms. Further analysis is needed to arrive at the perspective of comparing profitability and cost figures between the three sub-sectors, but it is worth nothing that **staff remuneration** makes up an especially large share in banking and other financial services.

Cross-border activity varies by sector. Banking and insurance services are mostly supplied domestically; to the extent that foreign actors are active, they tend to operate via local subsidiaries or branches or in the FPS form for insurance. This is similar for asset management, but the fund industry is essentially intra-EU, with nearly 70% of UCITS sold cross-border from hubs in Ireland and Luxembourg.

Finally, when it comes to the **customer breakdown**, for banking services nearly three quarters (73%) are supplied to businesses, followed by 22% to households and about 5% to governments. The share of B2B services was even more pronounced in other financial services, where SUT suggest a share of fully 90%, followed by about 9% supplied to households and just 1% to governments. In contrast to the other subsectors, a much larger share of insurance services (62%) is supplied to consumers, with 35% supplied to other businesses and about 3% to government actors. There is also some variation between countries within this broadly consistent picture.

5. VAT liability and compliance analysis

5.1 Introduction

5.1.1 Scope of work

The VAT liability and revenue analysis includes various inter-related analytical components, linked to actual VAT collection, alternative forms of "theoretical" receipts and forgone revenue. The analysis is presented after this introductory section, while more detail on the methodology applied is found in Volume 2, Annex 3.1. The notions in question are described in detail in Box 4.

Box 4. Definitions

VAT liability: this is the potential VAT revenue that would be collected for a given set of rules under conditions of full compliance or, in other words, if the existing tax base was effectively taxed. While liability differs from the VAT revenue that is actually collected, it is useful as an indication of the amount that should be expected. VAT liability could be attributed to specific tax bases depending on the tax treatment of different services, related either to input supplies or the consumption of financial services. The VAT liability for the whole economy or their groupings is referred to as the **VAT Total Tax Liability (VTTL)**.

Notional Ideal Revenue (NIR): the VAT revenue that would be collected if all transactions within the VAT base were taxed at the jurisdiction's statutory standard VAT rate, with no exemptions, reduced rates, or non-compliance. It can be estimated for the whole economy or for specific sectors, and serves as the benchmark for calculating the VAT policy gap.

VAT policy gap: the percentage of the NIR or monetary value forgone due to the application of exemptions and reduced rates under an assumption of full compliance. It can be further broken down to depict the effect of specific policies, such as the exemption for financial services.

VAT compliance gap: the difference between VAT liability and actual revenue. It shows forgone revenue due to non-compliance from fraud, evasion and legal tax optimisation in addition to bankruptcies, errors and omissions. As with the policy gap, it can be further broken down to depict its constituent parts. Making a sectoral breakdown of the VAT compliance gap also requires matching revenue and liability for the same tax base, i.e., aligning the calculation of the liability with revenue figures in tax registers. This requires applying the so-called production-side approach to the estimation of VAT liability, in which the liability is calculated as the sum of net collections from companies filing tax returns grouped by sectors of economic activity. In contrast, the consumption-side approach estimates the liability at the final stage of value added, adjusting for irrecoverable input VAT. This method provides estimates broken down by product groups rather than by sectors of economic activity, making it ill-suited to matching liability estimates with tax return data.

All in all, the analysis covers the following five elements (with the results presented in the terms explained in the italic text after each point):

1. **VAT liability** broken down according to the several constituent parts. These are: liability on the final use of services provided by the financial sector, irrecoverable VAT on the use of taxed financial services by economic operators without the right to deduct, distinguished between VAT-exempt sectors other than the financial sector and irrecoverable input VAT incurred by companies supplying financial services. This also covers the liability of the financial sector from the production-side, which is the difference between output VAT (for domestic inputs) and deductible input VAT.

   Presentation method: in EUR and as a percentage of the VTTL or actual VAT revenue, broken down by Member State and subsectors of the financial sectors (at 2-digit NACE breakdown).

2. **VAT burden on services provided to businesses and private customers**: the non-deductible elements of the VAT liability attributed to B2C and B2B transactions compared with the overall value of the supply of financial services to show the current effective VAT rate on final and intermediate use of these services.

   Presentation method: in EUR and as a percent of the supply, broken down by Member State and subsectors of the financial sectors (at 2-digit NACE breakdown).

3. **VAT revenue**: VAT remitted by financial service providers both gross and net (i.e., after accounting for deductible input VAT). Given the likely sensitivity of this information, the published report will not attribute estimates to specific Member States if this is requested by administrations.

   Presentation method: in EUR and as a percentage of total (net) VAT revenue, broken down by Member State and the subsectors of the financial sectors (at 2-digit NACE breakdown).

4. **VAT policy gap**: Forgone VAT revenue due to the application of the exemption and (as relevant) reduced rates on certain taxed financial services in some Member States.

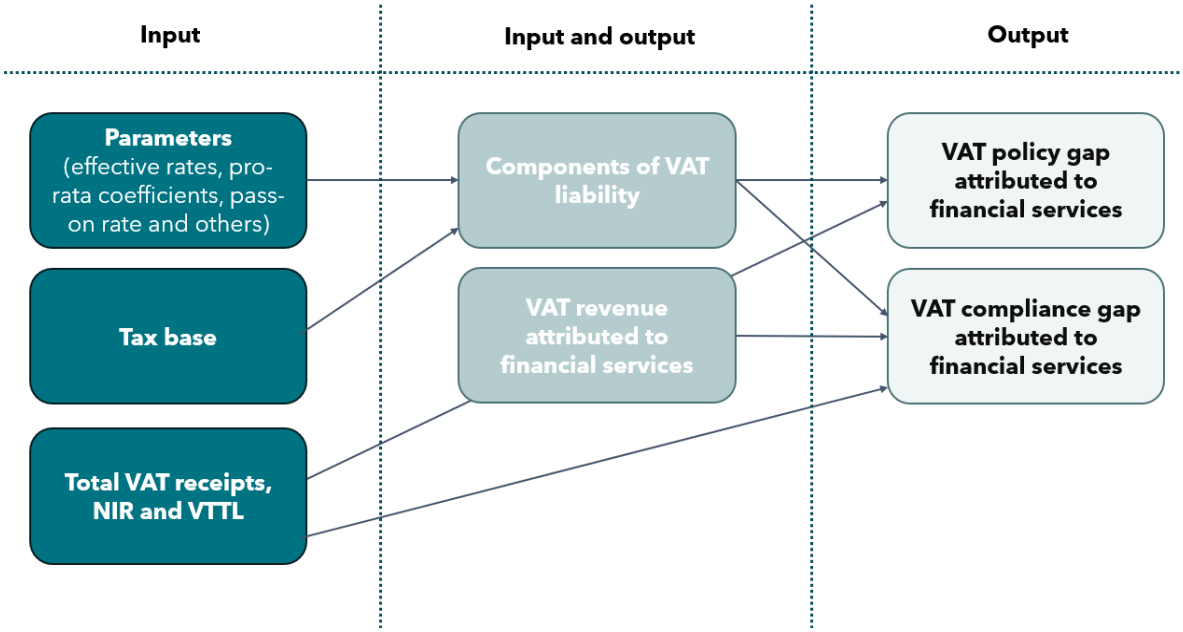
   Presentation method: in EUR, as a percentage of NIR or actual VAT revenue, as percent of the overall VAT policy gap, broken down by Member State and subsectors of the financial sectors (at 2-digit NACE breakdown).

5. **VAT compliance gap**: Forgone VAT revenue due to non-compliance from fraud, evasion and legal tax optimisation in addition to bankruptcies, errors and omissions. This component will aim to cover as large a number of Member States as possible. However, due to differences in classification standards and reliance on the data delivered by Member State administrations, this component may cover only selected Member States. In the published report, the estimates will not be attributed to specific Member States if this is requested by administrations.

   Presentation method: in EUR, as a percentage of the VTTL or actual VAT revenue, broken down by Member State and subsectors of the financial sector (at 2-digit NACE breakdown).

The five elements mentioned above are highly interrelated, which can be seen in Figure 42. The calculation of VAT liability requires information on the tax base and several other parameters. At the same time, sectoral VAT liability is an input to the calculation of the policy and compliance gaps. Similarly, VAT revenue serves as an output of the analysis and an input to the compliance gap estimation.

Figure 42. Main components of the analysis of VAT revenue and liability



Source: Authors' elaboration

The inputs for the calculations are gathered from the following sources:

Eurostat national accounts: these serve as the main source of information on the tax base. More specifically, the study team relies on the supply and use tables (SUTs) that provide important information on the input and output of the financial sectors broken down by groups of products. The information is available at two-

digit granularity level, namely for NACE / CPA K64, K65 and K66.[280] The data is currently available yearly, mostly up to 2021-2022 depending on the Member State. The SUTs were rescaled to match the 2023 tax base as discussed in Annex 2.

Eurostat government statistics: these provide information on total VAT collection. Due to the standardised and well-documented compilation standards used, these are the natural source of information on total VAT receipts.

1. VAT Gap in Europe study: the study is used to gather total value of NIR, VTTL and VAT policy and compliance gaps, which will serve as a reference for the sectoral gaps to be estimated empirically for this study. The most recent study available at the time of writing is the 2025 version, which includes full estimates up to 2023.
2. Own Resource Submissions: ORS are made of the VAT statements provided by Member States to the European Commission. They contain detailed information on the various VAT liability components. The information provided in the statements is broken down by groups of products and services, thus enabling the team to gather important parameters (e.g., 'pro-ratas' and average VAT rates) for financial services. As the detailed calculations of the weighted average rate have been discontinued, the most recent detailed calculations are available for 2020; access to this specific vintage of ORS was requested and granted in December 2024.
3. Direct requests to Member State's administrations: revenue data gathered by administrations from tax declarations contains information on the VAT charged on sales and deductible input tax broken down by sectors denoted by NACE classification. For most Member States, the data was made available for four-digit NACE codes.
4. Company-specific information gathered from the targeted consultation: this is used to fill the gaps in administrative data, i.e., to calculate the parameters characterising the financial sector in the absence of data from Member State administrations.

5.2 VAT liability

An essential precondition for assessing the functioning of the current VAT treatment and estimating the impacts of potential changes is a thorough understanding of the revenue implications of the existing arrangements. This section provides a detailed analysis of the **VAT liability attributable to services provided by the financial sector and non-deductible VAT on its inputs.** It offers a comprehensive overview of estimated VAT payments across the value-added chain, highlighting non-deductible elements and those that are deductible and therefore revenue-neutral. The primary objective is to identify where VAT is currently due under the existing rules and where it would not be due if these services were taxed differently.

VAT liability can be analysed from multiple perspectives, depending on how the tax base is defined. Two alternative approaches include:

- Attributing liability to the **use of services from the financial sector** (the "consumption-side" approach).
- Attributing liability to the **supplies of the financial sector** (the "production-side" approach).

Consumption-side estimates of VAT liability capture the potential revenue arising from three sources: VAT on the final use of taxable services provided by the financial sector, irrecoverable input VAT incurred in supplying non-taxable financial services, and non-deductible VAT incurred by business purchasers that are not entitled to deduct input VAT on taxable financial services. By contrast, the production-side approach measures VAT liability as the sum of VAT payments of financial services' providers, comprising output VAT and import VAT less deductible input VAT.

[280] NACE is the statistical classification of economic activities, whereas CPA refers to groups of products and services. While two distinct classification systems, they use an aligned set of codes.

Neither approach directly answers the question of what revenue would result from changes to the VAT treatment of these services. Instead, these formulations serve as proxies, representing the impact of these services not being consumed or produced in a hypothetical, counterfactual scenario.

The question of what would happen if the treatment changes will be addressed by the partial equilibrium model foreseen for the assessment of the impacts of different policy considerations part of the study. This model, in addition to simulating VAT burdens and payments along the value-added chains, also accounts for economic phenomena such as the impact of prices on supply and demand and the incomplete pass-through of the tax burden.[281] Moreover, the policy gap discussed in the Section 5.2.5 below – linked to the liability components mentioned earlier – already provides a simple calculation of the forgone revenue due to the current non-standard VAT treatment of financial services.

5.2.1 VAT payments along the value-added chain

The financial sector contributes to VAT revenue through various taxable and non-taxable activities, with differing implications depending on the type of transaction and the status of the recipient (see Figure 43).

For **taxable financial services**:

1. When supplied to private customers (households), the financial services sector generates output VAT on the value of the services supplied that amounted to an estimated **EUR 12.2 billion** in the EU in 2023.
2. When supplied to businesses with the right to deduct VAT, output VAT and deductible input VAT for companies purchasing these services is generated at the same time, totalling **EUR 24.3 billion** (in 2023). This could be viewed as a revenue neutral component as the purchasers could deduct this value from their output VAT liability. Still, it should be borne in mind that the value added of taxable financial services used as intermediate inputs is indirectly taxed at the final stage, when goods and services are supplied to end consumers.
3. For businesses without the right of deduction, Non-Profit Institutions Serving Households and government purchases, output VAT and non-deductible input VAT totalled **EUR 17.1 billion**, with most of this becoming hidden VAT attributable to the financial sector (purchasing financial services).
4. Overall, the financial sector deducts an estimated **EUR 30.1 billion** in VAT on its intermediate use and investment. This means that the difference between output VAT (points 1, 2 and 3) and deductible input VAT (point 4) was approximately **EUR 23.5 billion**.

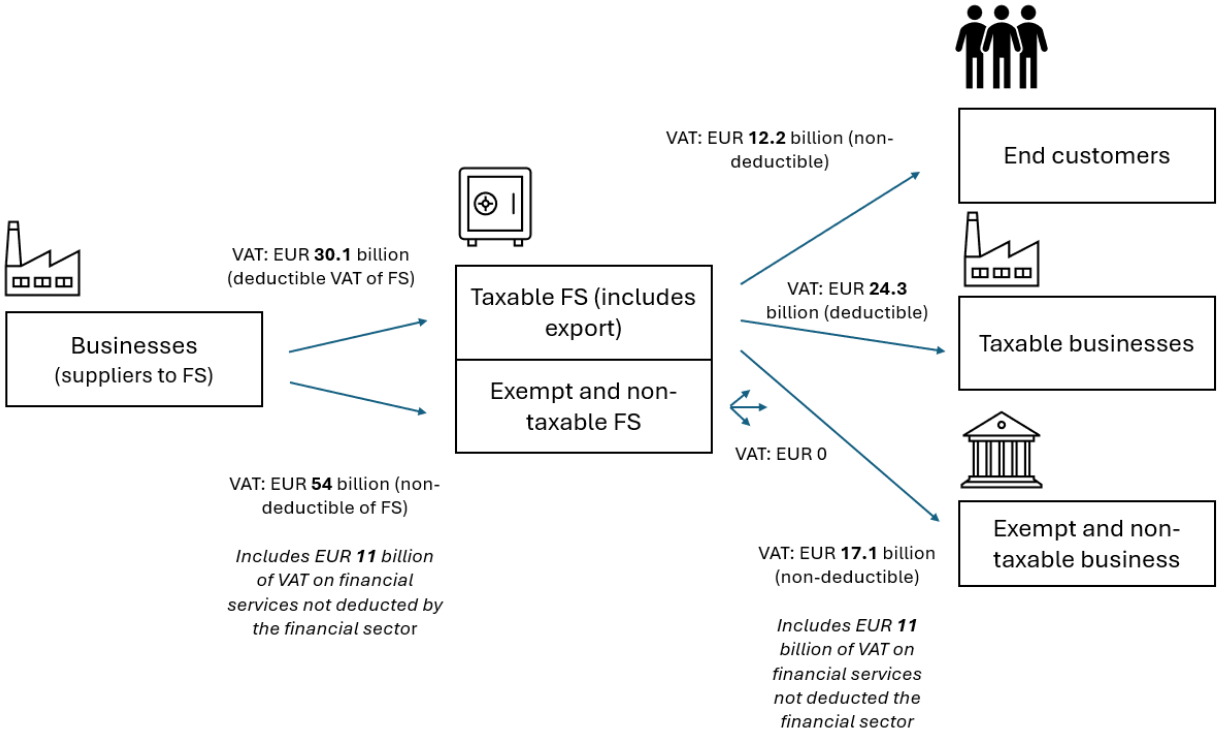
For **exempt and non-taxable financial services**:

1. Regardless of whether they are supplied to end customers or businesses, these services do not generate output VAT.
2. The VAT impact lies in the input VAT that cannot be deducted by the financial service provider, amounting to **EUR 54 billion** overall. Of this, **EUR 11 billion** is attributable to the non-deductible input VAT of taxed financial services[282], meaning VAT incurred by financial service providers. The EUR 54 billion can also be broken down into EUR 44.5 billion attributed to intermediate use and EUR 9.5 billion for investment in gross fixed capital formation (GFCF).

[281] Cf Volume 2 – Annex 2.1 for discussion on price elasticity of demand and supply, and pass through.

[282] This value is also included in EUR 17.1 billion VAT attributed to taxable financial services purchased by businesses without the right to deduct.

Figure 43. Overview of the estimated payments along the value-added chain of financial services (EU total, 2023)



Source: Authors' elaboration based on Eurostat, DG TAXUD (VAT Gap in Europe study) and direct data submissions from Member State tax administrations.

5.2.2 Consumption-side estimates of VAT liability

From the "consumption-side" approach, the VAT liability related to the financial sector can be broken down into three main components, namely:

1. VAT on the final use of taxable services provided by the financial sector;
2. irrecoverable input VAT incurred for the provision of non-taxable financial services; and
3. non-deductible VAT incurred by business purchasers (i.e. without the right to deduct input VAT) on taxable services provided by the financial sector.

Importantly, elements (2) and (3) are partly overlapping as they both account for non-deductible VAT on taxable financial services supplied to financial services companies. For this purpose, to avoid double counting, the third component – non-deductible VAT on taxable financial services of the business purchasers without the right to deduct input VAT – is shown solely for purchasers other than companies in the financial sector.

For conventional goods and services, where providers have a full right to deduct input VAT, the sole component of VAT liability is the VAT charged on final consumption. Under normal circumstances, if providers do not incur losses and the VAT rate on outputs is not at a reduced or zero-rate, the VAT charged on final consumption exceeds the VAT due at intermediate levels.

However, **the structure of VAT liability for the financial sector differs significantly from other sectors of the economy** primarily due to the exemption and related non-deductibility of much input VAT. **In 2023, the overall VAT liability associated with the use of services provided by the financial sector as a whole amounted to EUR 72.4 billion.** Of this total, only EUR 12.2 billion (16.9%) was attributable to final consumption (see Figure 44). Irrecoverable VAT on the intermediate consumption of financial services by other sectors (excluding financial services companies) amounted to EUR 6.2 billion (EUR 17.1 billion – EUR

11 billion) (8.8%). The largest share of VAT liability – EUR 54 billion (74.6%) – stemmed from irrecoverable VAT on inputs used by the financial sector.

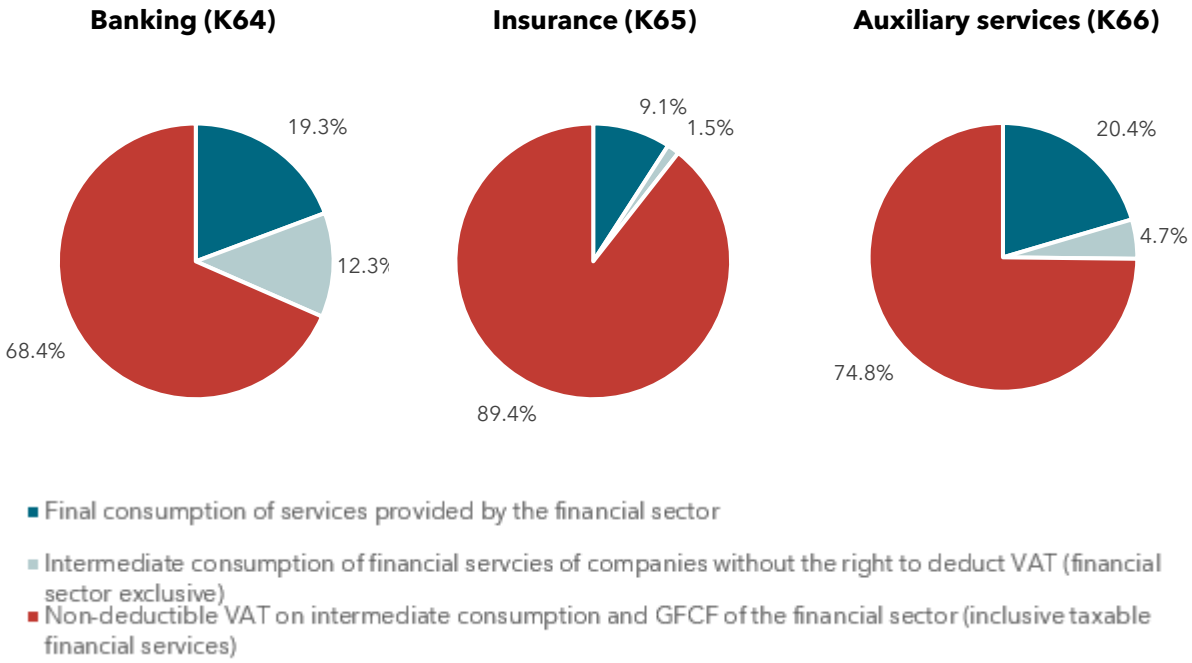
This implies that 83.1% of the VAT liability on services provided by the financial sector is "hidden," compared to 33.5% for the EU economy as a whole.

The relationship between the components of VAT liability differs somewhat across sub-sectors (see Figure 44). The share of hidden VAT on inputs as a proportion of the VAT liability attributed to the different subsectors is:

- 68.4% for banking,
- 89.4% for insurance, and
- 74.8% for other financial services.

As shown, the ratio of **hidden VAT was much higher for insurance than for the other subsectors**. This is due to its relatively low proportion of taxed output, which results in both relatively little output VAT and very limited recovery of the input VAT incurred. For banking services, a notable portion of the liability relates to services provided to companies (other than other financial services companies) without the right to deduct VAT, such as providers of healthcare and real estate services. Additionally, for the other financial services subsector, many services are used as intermediate inputs by banks and insurance companies. This results in a substantial share of the liability associated with non-deductible VAT on intermediate consumption and gross fixed capital formation (GFCF) in the banking and insurance subsectors, originating from their use of taxable services, such as related to asset management. More concretely, **hidden VAT attributed to the consumption of CPA K66 services (activities auxiliary to financial services and insurance) by NACE K64 (financial services) and K65 (insurance services) amounted to EUR 5.5 billion, equivalent to 7.6% of the total VAT liability associated with the financial services sector.**

Figure 44. Structure of the VAT liability on services provided by financial subsectors (EU, 2023)

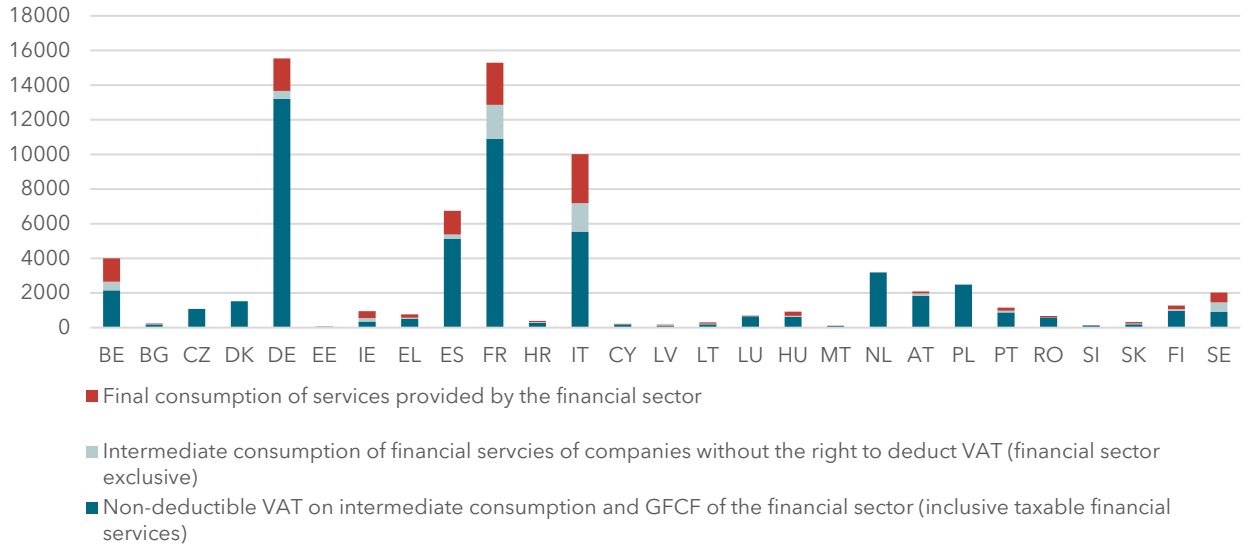


Source: Authors' elaboration based on Eurostat, DG TAXUD (VAT Gap in Europe study) and direct data submissions from Member State tax administrations

It is important to note that if services provided by the financial sector were fully taxable, no hidden VAT would be generated *within* the sector. However, some hidden VAT would still arise on the supply of financial services used by other exempt and non-taxable sectors.

When examining overall VAT liabilities in the financial sector, the largest nominal values were recorded in Germany (EUR 15.5 billion), France (EUR 15.3 billion), and Italy (EUR 10 billion). Unsurprisingly, the Member States with the highest VAT liabilities are those with the largest nominal value of final and intermediate consumption of these services.

Figure 45. Components of VAT liability associated with the use of services supplied by the financial services sector (EUR million, 2023)

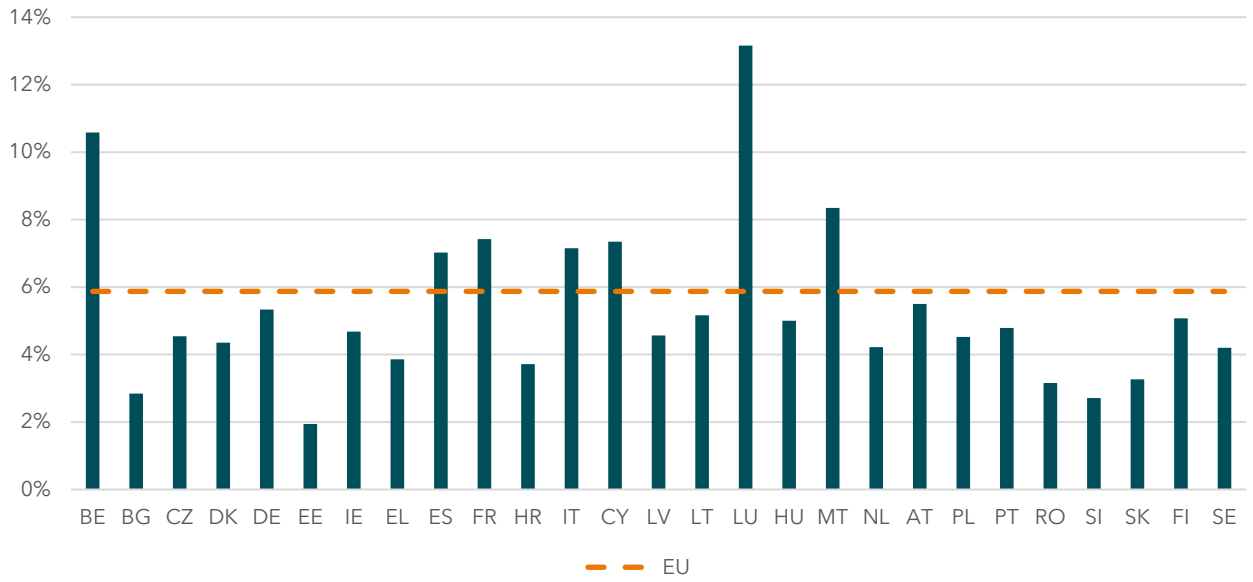


Source: Authors' elaboration based on Eurostat, DG TAXUD (VAT Gap in Europe study) and direct data submissions from Member State tax administrations. See Volume 2 -Annex 3.1

The VAT liability associated with the use of services provided by the financial sector accounted for 5.9% of EU-wide VAT revenue collected in 2023. However, the contribution varied significantly across Member States, ranging from 1.9% to 13.2%. The highest shares were recorded in Luxembourg (13.2%), Belgium (10.6%), Malta (8.3%), and France (7.4%), while the lowest shares were observed in Estonia (1.9%) and Slovenia (2.7%). These variations across countries can be attributed to differences in several factors:

- The relative size of the financial sector.
- The share of expenditure on financial services in consumption baskets.
- The extent to which activities in this sector are taxed.
- The broader policy gap and tax expenditure within national VAT systems.
- Country-specific sectoral characteristics (such as the share of intermediate inputs in overall costs).

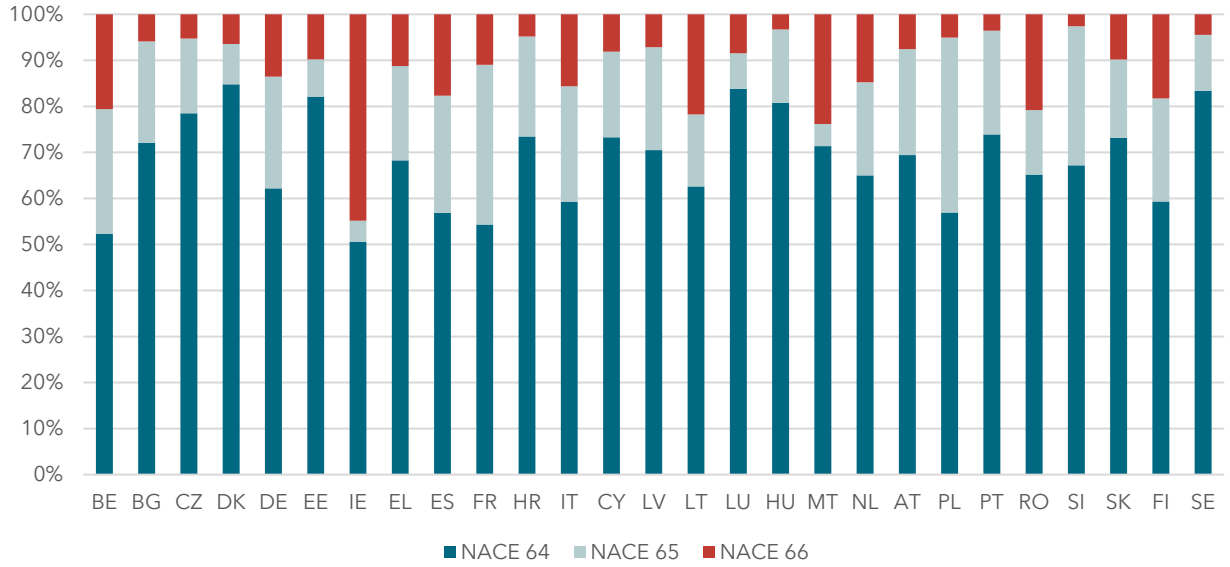
Figure 46. VAT liability associated with the use of services provided by the financial sector (% of total VAT revenue, 2023)



Source: Authors' elaboration based on Eurostat, DG TAXUD (VAT Gap in Europe study) and direct data submissions from Member State tax administrations.

Looking at the breakdown by subsector/group of services, 61.3% of the liability is associated with the banking industry, 25.5% with the insurance sector and 13.2% with other financial services. In nominal terms, these percentages corresponded to EUR 42.8 billion, EUR 17.8 billion and EUR 9.2 billion, respectively. Banking services accounted for over 50% of the VAT liability in all Member States (see Figure 47).

Figure 47. Breakdown of VAT liability associated with the use of services supplied by the financial sector (percent, 2023)



Source: Authors' elaboration based on Eurostat, DG TAXUD (VAT Gap in Europe study) and direct data submissions from Member State tax administrations.

5.2.3 Production-side estimates of VAT liability

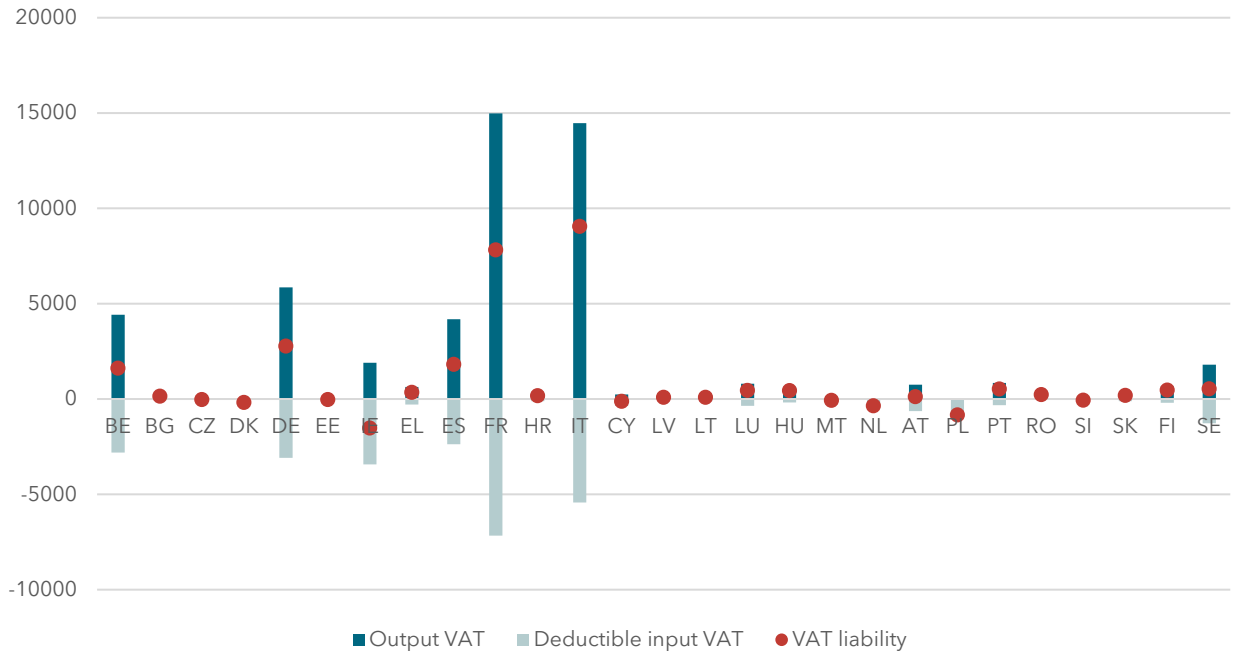
Although estimates of VAT liability from the consumption-side approach are more suitable for understanding the link between a sector's importance and the impact of its current VAT treatment, the **production-side approach can provide valuable insights when analysing issues related to VAT payments**. This section presents estimates of VAT liability using the production-side approach.

It should be noted that estimates using the production-side approach rely heavily on the accuracy of the assumed weighted average rates and pro-rata coefficients. These parameters have been calibrated compared to the numbers presented in the preliminary version of the report to improve the precision of estimates, which led to some non-negligible revisions.

In line with the VAT payment diagram (Figure 43) and discussions included in Section 5.2.1, **the estimated VAT liability of the sector from the production-side approach was EUR 23.5 billion**. In other words, if the sector were fully compliant (and refunds were not carried over between periods), the net VAT payments of financial companies would amount to 1.9% of total VAT revenue in the EU (in 2023).

The largest liability was estimated for Italy (EUR 9 billion) and France (EUR 7.8 billion), driven by relatively high average VAT rates on the services provided by the sector and the size of the sector (see Figure 48). In most cases (18 of 27), the estimates of the liability of the sector were positive, however, in nine cases, deductible input VAT exceeded output VAT. Low and even negative liability may occur when the VAT rate on inputs is higher than the rate on outputs, as is often the case with 'zero-rated' services exported to customers outside the EU. Negative estimates were recorded for Czechia, Denmark, Estonia, Ireland, Cyprus, Malta, the Netherlands, Poland, and Slovenia. In these countries, it is likely that many financial institutions had credit balances in their VAT returns, meaning that deductible input tax exceeded output tax collected.

Figure 48. VAT liability of financial companies, "production-side estimates" (EUR million, 2023)



Source: Authors' elaboration based on Eurostat, DG TAXUD (VAT Gap in Europe study) and direct data submissions from Member State tax administrations. See Volume 2 - Annex 3 - for estimates on output and deductible input VAT broken down by Member State and sector of economic activity

5.2.4 VAT burden in B2B and B2C transactions

The VAT liability estimates presented in Subsection 5.2.2, which include both VAT from taxing the supply of services to final users and hidden VAT, can be used to estimate the final VAT burden relative to the total value of services provided. This can be interpreted as **the effective VAT rate** for these services.

In this section, we present the results of these calculations for different types of services, distinguishing between intermediate uses (B2B, business-to-business, and B2G, business-to-governments) and, final uses (B2C, business-to-consumer transactions). It is important to note that the effective rate on B2B transactions is viewed from an "economic" rather than a "financial" perspective. This rate reflects the VAT burden that companies would bear on the purchase of financial services, excluding the contribution of financial services to the value of services provided by the purchaser. In other words, the estimated VAT burden on B2B transactions is comprised "only" of hidden VAT.

If services provided by the financial sector were fully taxable and provided exclusively to economic operators with a full right to deduct input tax, the VAT burden on B2C transactions would equal the standard VAT rate, while for B2B transactions it would be zero. However, since the final output of companies purchasing these services is taxed, the effective rate can also be viewed as the fraction of output VAT attributable to the value added of the financial services. As an example, a restaurant purchasing taxable financial services can deduct the corresponding input VAT, making it seem like the VAT is netted out. However, the financial services purchased by the restaurant, like the foodstuffs it acquires, enable the firm to produce and sell its outputs – food, drinks, etc. Consequently, these financial services are effectively taxed at the stage when meal services are provided to the end customer, based on their contribution to the value of the resultant service and at the VAT rate applicable to restaurant service.

The average effective VAT rate on services provided to private consumers was estimated at 6.5%, while the hidden VAT burden on B2B and B2G transactions was approximately 4.5% (see Table 25). This indicates that, for services provided to end customers, the VAT treatment was more favourable than is the case for most other services. Conversely, due to the prevalence of hidden VAT, for services provided to businesses and government, the VAT burden was higher than for services where VAT is fully deductible.

Examining cross-country differences, the highest effective rates – of nearly 10% for B2C transactions – were estimated for Croatia, Latvia, Lithuania and Romania. The lowest effective rates for B2C transactions, below 3%, were recorded in Malta and the Netherlands. For B2B and B2G transactions, the lowest rates were estimated for Luxembourg, Malta, and Ireland.

Table 25. VAT burden in B2B, and B2C and B2G transactions (% of gross value, in 2023)

	VAT burden -- B2C (% of gross value)				VAT burden -- B2B and B2G (% of gross value)			
	Banking	Insurance	Auxiliary services	TOTAL	Banking	Insurance	Auxiliary services	TOTAL
BE	14.0%	4.6%	12.9%	**8.4%**	6.1%	3.8%	2.6%	**4.6%**
BG	4.5%	2.8%	6.1%	**4.2%**	2.2%	2.8%	5.5%	**2.4%**
CZ	8.3%	2.7%	1.9%	**5.5%**	8.3%	2.7%	1.9%	**5.5%**
DK	7.3%	2.0%	5.5%	**5.8%**	7.3%	2.0%	5.5%	**5.8%**
DE	9.4%	3.1%	20.1%	**6.6%**	6.0%	2.7%	19.9%	**5.0%**
EE	5.3%	1.6%	3.5%	**4.4%**	3.7%	1.6%	3.5%	**3.3%**
IE	14.1%	0.8%	8.2%	**5.7%**	2.5%	0.0%	4.8%	**1.5%**
EL	8.3%	5.9%	26.2%	**8.1%**	4.4%	5.3%	11.7%	**5.1%**
ES	9.4%	5.3%	15.3%	**9.2%**	7.4%	5.5%	2.1%	**5.9%**
FR	16.3%	4.4%	.	**6.7%**	5.2%	3.9%	6.2%	**4.9%**
HR	13.6%	12.9%	6.5%	**11.4%**	6.7%	12.4%	4.3%	**7.4%**
IT	15.7%	5.0%	11.3%	**9.0%**	5.5%	3.3%	4.6%	**4.7%**

	VAT burden -- B2C (% of gross value)				VAT burden -- B2B and B2G (% of gross value)			
	Banking	Insurance	Auxiliary services	TOTAL	Banking	Insurance	Auxiliary services	TOTAL
CY	7.6%	6.3%	10.8%	**5.9%**	4.4%	4.9%	0.8%	**3.3%**
LV	15.0%	7.7%	12.6%	**11.0%**	7.5%	8.3%	8.2%	**7.8%**
LT	13.4%	5.5%	15.6%	**11.1%**	6.7%	5.7%	12.9%	**7.4%**
LU	6.5%	1.1%	.	**3.2%**	0.9%	1.1%	0.2%	**0.7%**
HU	10.9%	4.2%	20.7%	**9.2%**	6.9%	4.1%	9.3%	**6.1%**
MT	2.9%	1.0%	7.7%	**2.7%**	1.2%	1.0%	3.9%	**1.4%**
NL	4.2%	1.0%	13.6%	**2.7%**	4.2%	1.0%	13.6%	**2.7%**
AT	11.7%	4.8%	8.0%	**7.6%**	8.2%	4.4%	6.4%	**6.8%**
PL	5.1%	8.4%	1.6%	**5.3%**	5.1%	8.4%	1.6%	**5.3%**
PT	9.0%	4.3%	11.1%	**6.9%**	5.9%	4.1%	4.9%	**5.4%**
RO	7.0%	6.4%	24.8%	**11.4%**	7.0%	7.1%	5.6%	**6.8%**
SI	5.9%	2.7%	2.5%	**4.3%**	4.9%	2.7%	2.5%	**3.8%**
SK	10.2%	2.4%	6.9%	**6.6%**	5.5%	2.5%	3.9%	**4.3%**
FI	8.2%	6.6%	13.6%	**8.4%**	6.6%	4.2%	7.6%	**6.1%**
SE	12.8%	3.5%	6.8%	**8.5%**	8.1%	2.7%	2.3%	**6.6%**
TOTAL	**9.7%**	**3.7%**	**11.1%**	**6.5%**	**5.3%**	**3.2%**	**4.7%**	**4.5%**

Source: Authors' elaboration based on Eurostat, DG TAXUD (VAT Gap in Europe study) and direct data submissions from Member State tax administrations

5.2.5 Policy gap

The economy-wide VAT policy gap can be defined as the difference between actual VAT Total Tax Liability (VTTL) and Notional Ideal Revenue (NIR) – the theoretical, counterfactual liability that would result from applying the standard VAT rate universally to aggregate net final consumption and housing investment.

In this section, we present estimates of the policy gap attributed to services provided by the financial sector and break down the estimates further to attribute forgone revenue to three financial services sub-sectors/groups of services: banking (NACE/CPA 64), insurance (NACE/CPA 65) and asset management (NACE/CPA 66). It is important to note that for estimating potential increases in VAT revenue, we assume that all financial services would become taxed and that the gross tax base remains unchanged. We then estimate potential revenue and compare it with the VAT liability estimates presented in Section 5.2.2.[283]

This theoretical approach to NIR naturally omits various economic effects, particularly general-equilibrium and second-order effects that would likely occur due to increased tax rates and the removal of exemptions. It also does not account for imperfect compliance. While these assumptions simplify reality, the VAT policy gap remains a valuable measure of the impact of exemptions on VAT liabilities. The policy gap estimation methodology allows VAT policy structures to be modelled in detail, including variations in tax rates across different types of use. This provides a clearer understanding of how exemptions influence VAT revenue.

In nominal terms, the VAT policy gap for all financial services was estimated at EUR 52.2 billion of which EUR 9.6 billion is attributed to the banking sector, EUR 44.9 billion to the insurance industry and the policy gap for the sector providing other financial services was negative (EUR -2.3 billion). In other words, if all the financial services were to become taxable, the VAT liability on the use of services provided by investment services companies (K66) would decline. This is because these services are mostly

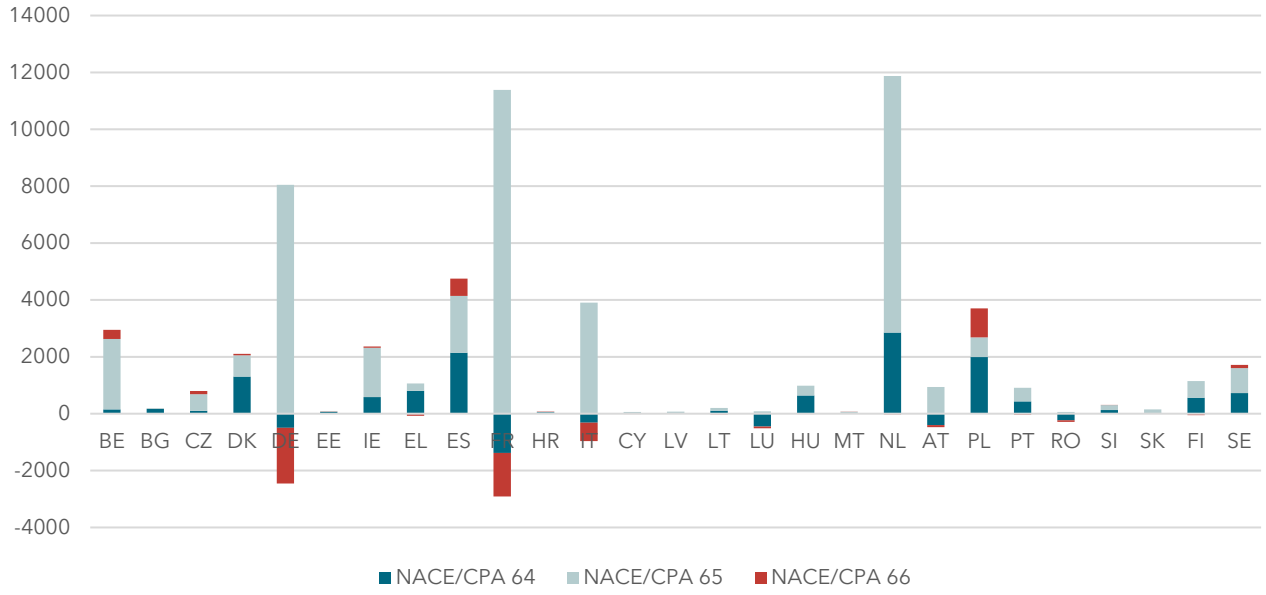
[283] Policy Gap components are non-deductible. For example, if only asset management services were taxed while banking and insurance services remained exempt, the impact of the tax would be disproportionately higher on the former while additional hidden VAT would be generated.

used as intermediate inputs (B2B transactions). The ratio of policy gaps for the three analysed subsectors was rather consistent between countries (see Figure 49).

The **largest nominal policy gaps were estimated for the Netherlands (EUR 11.9 billion), France (EUR 8.5 billion), and Germany (EUR 5.6 billion)**. These gaps result from the size and structure of the respective tax bases, as well as the difference between the current effective VAT rate and the statutory rate in each country.

Overall, the **policy gap for the financial sector was negative in two Member States** (Luxembourg and Romania). This is consistent with the estimates presented in the *2025 VAT Gap in Europe* report. The negative gap was largest (both in nominal terms and as a share of national VAT revenue) in Luxembourg (see Figure 50). This is related to its relatively large value of financial services and the fact that they are used primarily as intermediate inputs or exported. Romania also shows relatively high shares of B2B consumption of financial services. For both countries with a negative gap, it follows that, in a counterfactual scenario in which these services were taxed, the financial sector would be able to deduct input VAT, in turn reducing VAT revenue. [284] At the same time, there would be no gains from imposing output VAT on services provided domestically, since business customers would in principle be able to deduct their input VAT downstream.[285]

Figure 49. VAT policy gap for services provided by the financial sector (by subsector, EUR million, 2023)



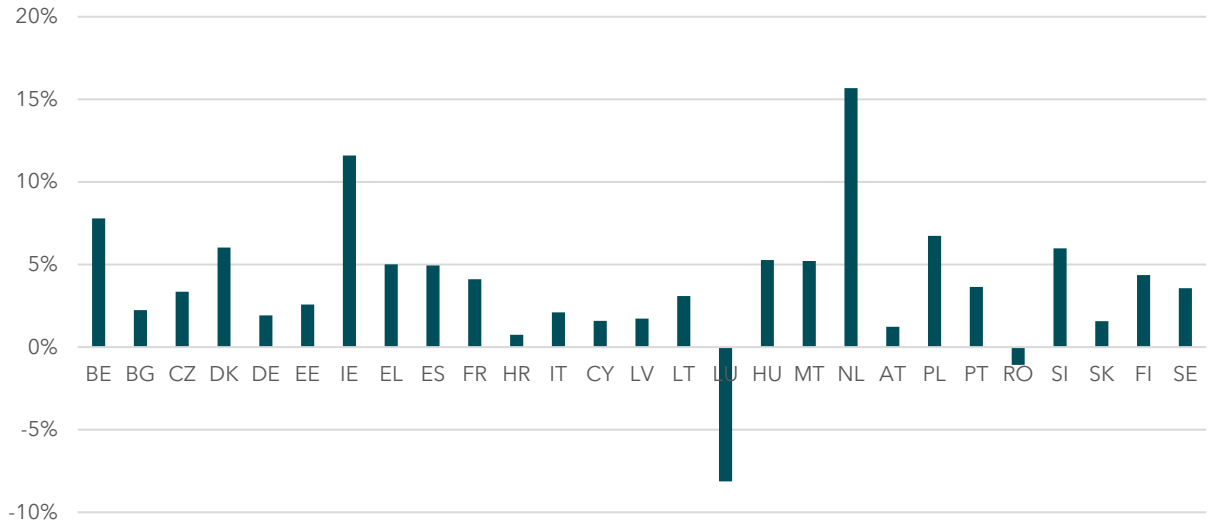
Source: Authors' elaboration based on Eurostat, DG TAXUD (VAT Gap in Europe study) and direct data submissions from Member State tax administrations. See Annex 3 - Statistical Annex for estimates on output and deductible input VAT broken down by Member State and sector of economic activity.

In relative terms, **the total policy gap attributed to services provided by the financial sector represents 4.4% of actual (total) VAT revenues**, which is equivalent to **1.8% of the notional ideal revenue**. The largest policy gaps in relative terms were estimated for the Netherlands (14.8% of actual VAT revenue), Ireland (11.6%), and Belgium (7.8%). In these countries, the financial sector is relatively large, and/or the current effective VAT rates are relatively low. Apart from these countries, the policy gaps in most of the other Member States ranged from 0% to 5% of VAT revenue (17 of 27 Member States).

[284] European Commission: Directorate-General for Taxation and Customs Union, Bonch-Osmolovskiy, M., Poniatowski, G., Braniff, L., Harrison, G. et al., (2024) VAT gap in the EU – 2024 report, Poniatowski, G.(editor), Publications Office of the European Union, https://data.europa.eu/doi/10.2778/2476549.

[285] In a counterfactual extreme situation where financial services are only purchased by taxable businesses, bringing financial service providers into the VAT system would only result in the financial sector being able to deduct input VAT while not having any impact on the revenue collected at the final stage of the value chain.

Figure 50. VAT policy gap for services provided by the financial sector (% of actual revenue, 2023)



Source: Authors' elaboration based on Eurostat, DG TAXUD (VAT Gap in Europe study) and direct data submissions from Member State tax administrations. See Volume 2 - Annex 3.1 for estimates on output and deductible input VAT broken down by Member State and sector of economic activity

5.3 VAT payments based on tax returns

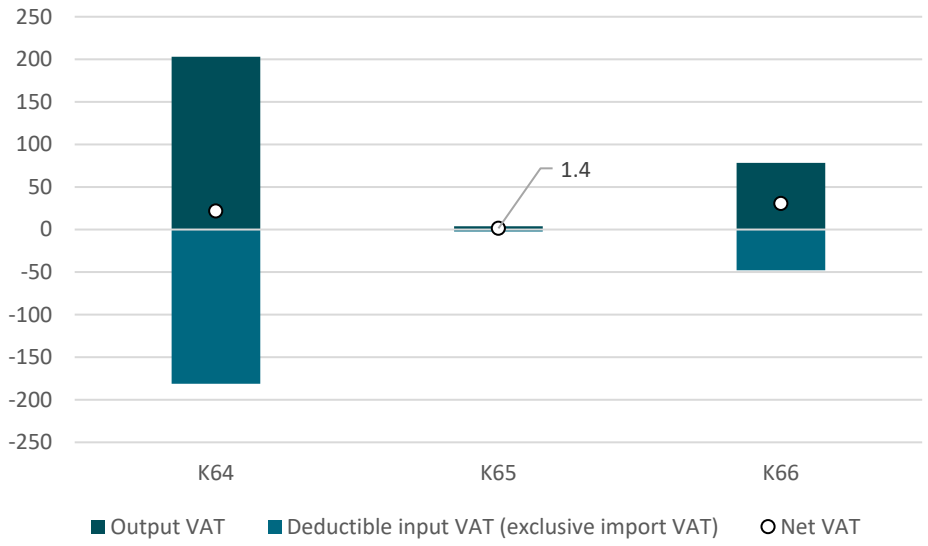
This short section discusses the VAT remitted by financial service providers, both in gross terms and net of deductible input VAT. Due to the sensitivity of this information, the figures are presented only as an aggregate of the values provided by 19 tax administrations. Even if anonymised, the data could potentially be attributed to specific Member States and, particularly, larger ones or those that are major exporters of financial services. Although this information must be presented in aggregate, the VAT liability analysis, which covers all Member States and their components, is shown in full detail above and thus complements the picture.

It is important to note that the revenue recorded in tax returns – used to approximate production-side estimates of VAT liability – reflects a *financial* rather than an *economic* perspective (see Section 5.2). Moreover, in some Member States, the figures derived from tax returns do not cover all financial companies (e.g. smaller taxpayers and those that do not deduct any input VAT).

Overall, the **output VAT reported by the financial sector amounted to EUR 285 billion**, the majority of which was recorded by companies classified under NACE 64 (EUR 203 billion)[286]. Providers of auxiliary financial services accounted for EUR 78 billion, while insurance companies reported only EUR 4 billion in gross output VAT. Of the total EUR 285 billion, over 80% was deducted as recoverable input VAT. **The total net VAT remitted by the financial services subsector amounted to EUR 22 billion for banking, EUR 1 billion for insurance, and EUR 31 billion for auxiliary financial services** (see Figure 51).

[286] According to one of the administrations that provided underlying data, the number is distorted by single company registered under the NACE code of 64.2 (activities of holding companies).

Figure 51. Gross and net VAT in 19 Member States (EUR billion, 2023)



Source: Authors' elaboration based on responses from tax returns' data provided within the stakeholder consultation. See Volume 2- Annex

5.4 VAT non-compliance and forgone revenue

5.4.1 Introduction

This section presents the analysis of VAT compliance in the financial sector, from two perspectives. The principal analysis entails calculating sectoral VAT liability using the so-called top-down production-side approach and comparing it with the actual revenue recorded by tax administrations. This is complemented by an analysis of reported detected irregularities, based on the information shared by several tax administrations.

Before discussing the results, several points on the sector and the methodology are mentioned as a starting point. First, a priori the financial sector is not considered a candidate for major VAT fraud or evasion. This is due to key characteristics such as the exempt nature of most financial outputs, prevalence of large firms and strict regulatory framework applied to financial institutions. Limited amount of forgone revenue would thus be expected, as is indeed consistent with the available secondary analyses.[287]

Regarding the methodology for the production-side approach (see explanation in Section 5.2.3), in practice this involves calculating the VAT liability for a sector of economic activity (i.e., grouping all companies from a sector) by summing up its output and import VAT, adjusted for deductible input VAT. Since the calculation is performed at the sectoral level, the resulting VAT liability estimates can be compared with data from VAT returns and actual VAT collection.

However, though widely used for estimating compliance gaps, this methodology, raises significant challenges in the case of the financial services sector. One of these is the high degree of measurement error, which refers to both tax base value and the parameters describing its VAT treatment. More specifically, the challenge is that the top-down production-side approach relies on national accounts data as a proxy for the actual tax base. However, the varied VAT treatment in the financial sector means that critical information needed to estimate certain parameters for the VAT rules is not publicly available and instead must be collected directly from tax authorities. As a result, the estimated parameters reflect

[287] Specifically, IMF country reports for Belgium, Finland and Poland show that the contribution of the financial sector to the overall compliance gap, measured both as a share of the total gap and as a percentage of GDP, is very low, with revenue losses from the combined financial and real estate sectors amounting to less than 0.1% of GDP. See IMF Country Report No. 18/357, IMF Country Report No. 16/60 and IMF Country Report No. 23/166.

reported rather than *actual* tax bases, introducing a bias that is not present in the calculation for sectors with homogenous VAT treatment in terms of statutory rate applied and the right to deduct input VAT. The accuracy of the estimates also depends on other factors, such as the availability of up-to-date and reliable national accounts data, and the consistency of classification between fiscal data and national accounts.

Moreover, the calculation of one of the three main components of the model used for the calculations – import VAT – is likely subject to relatively large inaccuracies, as the product and service breakdown of imports by sector of economic activity was not available to the study team. Consequently, the study team had to assume that the structure of imports, in terms of product and service categories, mirrors the structure of total inputs, as reported in the Eurostat use tables. Yet, compared to total input VAT, import VAT (both intra- and extra-EU) is relatively small, as imported goods and services accounts for approximately 17% of sector's intermediate use.

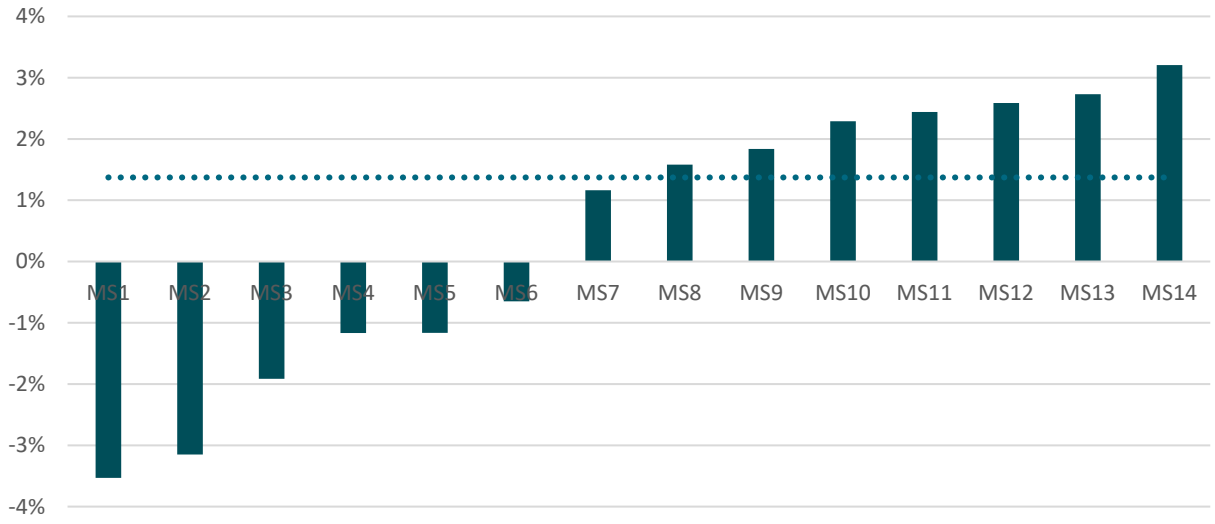
Finally, although the VAT liability for the NACE sectors of interest 64–66 could be estimated for all EU Member States, corresponding revenue figures based on VAT return data were available for only 14 countries. This limitation arises either from the unavailability of sectoral revenue data or because, in some Member States, the available data do not cover the entire sector, which prevents a full analysis.

For these reasons, **the analysis should be regarded as an 'acid test' rather than a precise measurement of fraud and evasion**. It is also why the complementary analysis is included on detected irregularities, as mentioned above. When reading the results, it should also be borne in mind that, due to the sensitivity of compliance data, the names of Member States and other identifying information (e.g., sectoral turnover) are not mentioned. Rather, the text uses anonymous formulations (MS 1, MS 2 etc.) and refers to proportions of sectoral turnover in given countries as a frame of comparison.

5.4.2 Findings

For the 14 Member States included in the analysis, **the sum of the compliance gaps was close to zero**. At the country level, the median gap was about 1% of sectoral turnover, with gaps varying from slightly positive to slightly negative as would be expected given the fairly large margin of error (Figure 52). Still, the key finding is clear, which is that there are no major discrepancies in the liability and revenue figures.

Figure 52. Difference between the estimated liability and actual collection (2023, % of the sectoral turnover)



Source: Authors' elaboration based on responses from tax returns' data and Eurostat
Note: Due to the uncertainty and sensitivity of these findings, the results are presented in anonymised form

The estimates of the compliance gap are corroborated by audit findings, which (with one exception discussed below) are indicative of a sector with very limited fraud issues. The yearly average of **irregularities detected** by tax control authorities between 2019 and 2023, in the 20 Member States for which data was available, amounted to EUR 520 million, i.e. 0.05% of sectoral turnover. The highest value

was observed in the banking industry, at EUR 400 million (Figure 53). This reflects both the relatively large size of banking and its higher share of detected irregularities compared to the insurance and other financial services subsectors (Figure 54). The findings are consistent with consultation data suggesting greater compliance difficulties in banking, which is due to the diversity of activities in the sector, uncertainty about tax treatment in some cases and resulting challenges to calculate input VAT pro-ratas. The lowest level of irregularities was observed in the insurance subsector, amounting to EUR 39 million, or 0.02% of turnover in the 20 Member States considered.

In the same 20 Member States, tax authorities reported **just under 13,000 audits per year** of companies from the financial sector, whose scope included indirect as well as direct taxes. Similar to the distribution of irregularities, the highest number of audits was observed in the banking industry (Figure 55). Audits of insurance companies were relatively few, but their yield was substantially higher than in other subsectors, amounting to EUR 80,000 per audit.

Figure 53. Value and split of detected VAT-related irregularities by sector of economic activity (yearly average, 2019-2023)

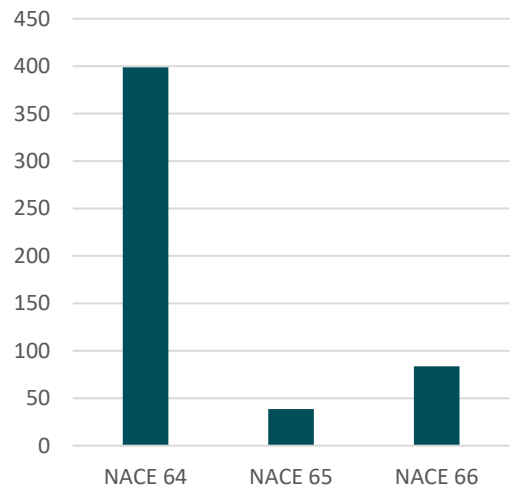


Figure 54. VAT-related irregularities to turnover by sector of economic activity (yearly average, 2019-2023

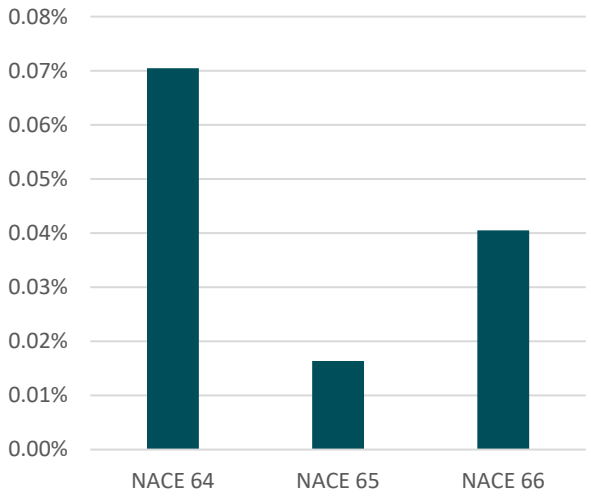


Figure 55. Number of VAT-related audits by sector of economic activity (yearly average, 2019-2023)

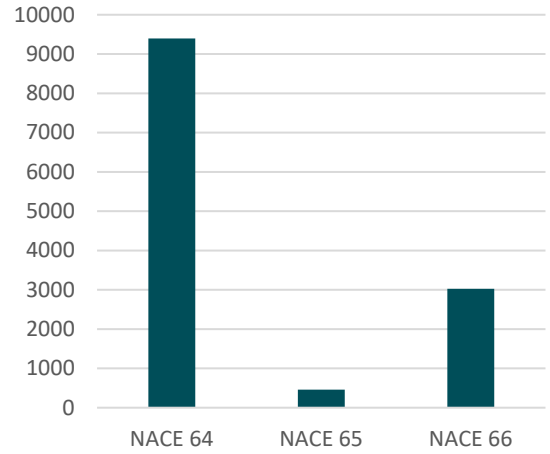
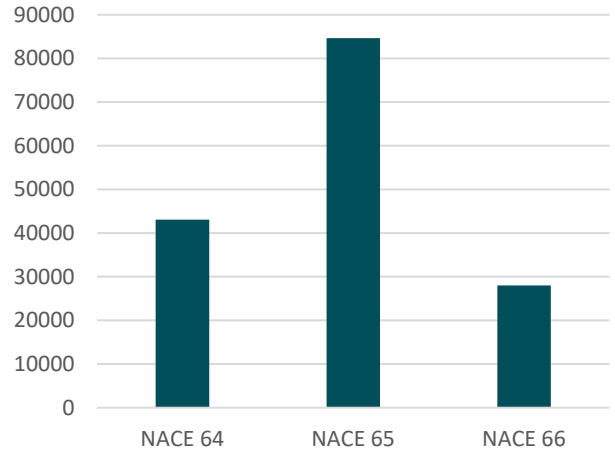


Figure 56. Audit yield by sector of economic activity (EUR, 2019-2023)

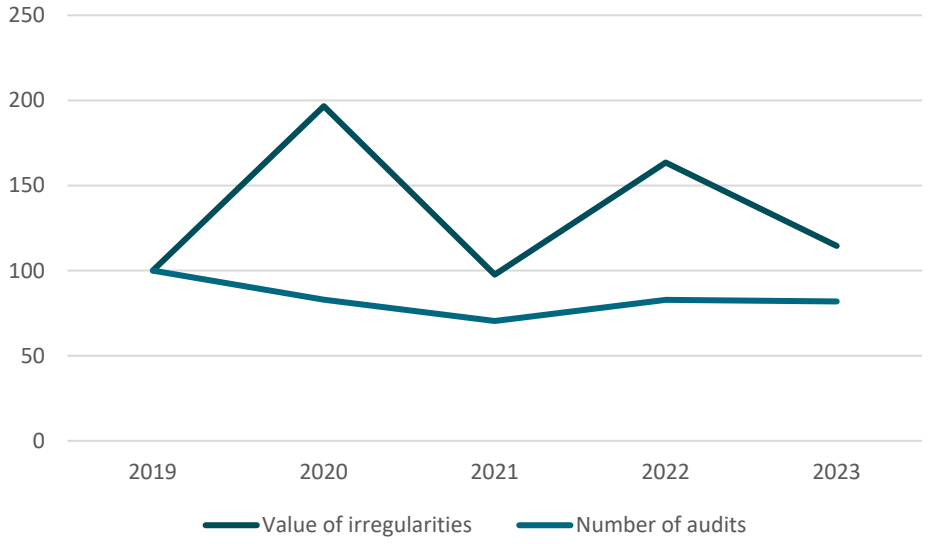


Source: Authors' elaboration analysis based on responses from tax audit data
Note: Average values for the period covered with responses (2019-2023). Based on data for 20 MS

Looking at the estimates for individual countries, one Member State reported a relatively high value of detected irregularities – nearly 1.4% of turnover. This suggests the presence of large-scale fraud rather than isolated cases of non-compliance. In 18 out of 20 Member States, the value of detected fraud cases was

below 0.2% of turnover. From a time perspective, despite some non-negligible fluctuations, both the value of detected irregularities and the number of audits have followed a sideways (i.e., relatively flat) trend. This suggests that, during the period covered, there were no major changes in the compliance levels of financial service providers. At the same time, the figures regarding the number of audits do not appear to be driven by shifting priorities or changes in the modus operandi of tax control authorities, such as the increased audits in the sector that would have been expected from perceived fraud concerns.

Figure 57. Value of VAT-related irregularities and number of audits (2019=100, 2019-2023)



Source: Authors' elaboration based on responses from tax audit data
Note: Based on data for 17 MS

Indeed, complementing, the numerical evidence, tax authorities confirmed that compliance issues in the financial sector were not perceived as a major problem by either economic operators or the authorities themselves. According to the consultation responses, the main concerns regarding non-compliance related to pro-rata calculations and the scope of applied exemptions (i.e., the tax treatment of certain services), rather than large-scale fraud.

The banking sector, which as mentioned is more diverse than others and includes a wide range of exempt and taxed activities, faces the most frequent issues across EU Member States, including pro-rata/overstated deductions (15 of 22 total responses), misalignment of exemptions and VAT rates (11 responses), and other issues (10 responses), such as employment taxation, corporate tax concerns, and irregularities related to taxable profits. These findings reflect the complexity of VAT liability calculations in this sector compared to other financial subsectors.

The insurance sector also shows widespread issues with pro-rata/overstated deductions (12 responses), though fewer concerns were reported regarding the alignment of exemptions (six responses) and other issues (eight responses). Finally, the asset management (i.e. other financial services) subsector reported the fewest irregularities, with pro-rata/overstated deductions mentioned nine times, misalignment of exemptions six times, and other issues nine times.

5.5 Summary

This chapter had the aim of shedding light on the structure of VAT in the financial sector and the implications of this in terms of the amount and composition of VAT liability. The analysis was conducted based on the most reliable sources of information, namely, national accounts as a source for the tax base and tax return data as a source for VAT policy-related parameters.

As a headline figure, the analysis arrived at an **overall VAT liability attributed to the financial services sector from the consumption-side approach of EUR 72.4 billion**, including both VAT on the use of

services provided by the sector and the sector's non-deductible (hidden) VAT. This is **equivalent to 5.9% of total EU VAT revenue in 2023.** Of this total, only EUR 12.2 billion (16.9%) was attributable to final consumption. Irrecoverable VAT on intermediate consumption of financial services by other sectors (excluding financial services companies) amounted to EUR 6.2 billion (8.8%). The **largest share of VAT liability – EUR 54 billion (74.6%) – stemmed from irrecoverable VAT on inputs** used by the financial sector.

The estimated VAT liability of the sector using the production-side approach was EUR 23.5 billion. In other words, if the sector was fully compliant and refunds were not carried over between periods, the net VAT payments of financial services companies would amount to the equivalent of 1.9% of total VAT revenue in the EU. The estimates of the liability of the sector were positive for 18 Member States; however, deductible input VAT exceeded output VAT in nine countries, meaning that more input VAT is deducted than output VAT due.

In relation to the above, the structure of VAT liability for financial services and its respective subsectors differs significantly from that of the rest of the economy, primarily **due to the exemption and the related non-deductibility of much input VAT**. More specifically, 83.1% of the VAT liability on services provided by the financial sector is "hidden," compared to 33.5% for the EU economy as a whole.

The average effective VAT rate on services provided to private consumers was estimated at 6.5%, while the hidden VAT burden on B2B transactions was approximately 4.5%. This indicates that, **for services provided to end customers, the current VAT treatment was more favourable than for most other services.** Conversely, **for services provided to businesses, the VAT burden was higher than for services where VAT is fully deductible by the service provider**.

In nominal terms, **the VAT policy gap, i.e., the measure of forgone revenue due to the policy structure characterised by the exemption on financial services, was estimated at EUR 52.2 billion**. Of this, EUR 9.6 billion is attributed to the banking sector and EUR 44.9 billion to the insurance industry. For other financial services (comprised mostly of asset and fund management), the policy gap was negative (EUR -2.3 billion), meaning that in a theoretical scenario without the exemption, the VAT liability would actually decrease. In relative terms, the total policy gap attributed to services provided by the financial sector was 4.4% of actual (total) VAT revenue, equivalent to 1.8% of the notional ideal revenue.

The analysis of the VAT compliance gap and irregularities identified through audit results confirms the initial assumption that the financial sector is not a major source of VAT fraud or evasion. Estimates of the VAT compliance gap were on average around one percent of sectoral turnover with some negative values estimated, suggesting that measurement error may exceed the size of the gap itself. This is further supported by audit data: in the 20 Member States that provided relevant information, detected VAT irregularities amounted on average to just 0.05% of sectoral turnover. As resulted also from the stakeholders' consultation, the main compliance concerns related to pro-rata calculations and the scope of applied exemptions (i.e. the tax treatment of certain services), rather than to large-scale fraud or evasion.

6. Mapping and analysis of sectoral taxes applied to the Financial Sector

6.1 Introduction

This chapter moves from VAT to other sectoral taxes that are levied at national level on the financial sector in the EU. This is an important element of the analysis, considering that these taxes must be considered in conjunction with any future reform of the VAT exemption framework.

To maintain focus and manage the scope of this analysis, it specifically addresses taxes that target financial services or financial services providers explicitly. The relevance of a tax on financial services or institutions is assessed based on three key conditions: (i) its rationale, such as whether the tax compensates for the VAT exemption (e.g., insurance premium taxes or payroll taxes); (ii) its tax base, determining if it operates as an ad valorem sales tax on relevant products (e.g., financial transaction taxes or insurance premium taxes); and (iii) whether it is a sector-specific levy, predominantly applied to e.g. banks or insurance companies. General taxes, e.g. taxes on companies' profits, withholding taxes and those affecting individuals are excluded. Consequently, the study does not cover taxes on personal income for employees in the financial services sector or taxes on capital, capital gains, savings, and investments, as these apply to individual incomes or assets rather than financial companies or their products.

Building on this framework, the analysis focuses on several categories of taxes, grouped as follows:

1. **Taxes on the sale of certain products** (e.g., insurance premium taxes (IPTs) and certain stamp duties);
2. **Financial transaction taxes** (FTTs);
3. **Financial institution levies**, which encompass different types of additional taxation measures for financial institutions, such as bank levies that were introduced in the aftermath of the 2007-09 financial crisis;
4. **Payroll taxes**, referring to additional taxes on staff salaries;
5. **Additional Corporate Income Tax** (CIT) levied specifically on (certain) providers of financial services;
6. So-called **windfall taxes**, targeting windfall gains occurring in the financial sector due to unforeseen circumstances.

Relevant national taxes were identified starting from available public sources, in particular the Commission's TEDB database and Eurostat's national tax list (latest data for 2023), whereby the latter was used primarily for the collection of tax revenue figures. The list was also compared with the one compiled during the previous study, which proved to be still largely accurate. The identified sectoral taxes were cross-checked with national authorities during the targeted consultation. This approach ensured the collection of consistent and up-to-date information, particularly capturing the taxes deemed most significant by tax authorities. However, a key limitation is the potential exclusion of a small subset of relevant taxes. To this end, the results were further triangulated with a **recent study published by the European Parliament on the taxation of the EU's financial sector**.[288] The study focuses more on the banking sector, rather than the insurance sector / financial services sector as a whole, but yielded similar results in terms of the fragmentation of the sectoral tax framework for the financial services sector.

[288] European Parliament (2025), *The taxation of the EU's financial sector. Options and experiences*, prepared by Atanas Pekanov and Margit Schratzenstaller from Austrian Institute for Economic Research, prepared for FISC Subcommittee.

The taxonomy and results in this chapter differ in some respects from those in this study. The primary source of divergence is scope, as this study covers the financial sector as a whole, including insurance, whereas the EP study focuses on the banking sector and financial transactions. As a result, this study captures a substantially larger universe of tax measures – notably insurance premium taxes. Beyond scope, the two studies also differ in their taxonomies: certain measures classified here as additional CIT or financial institution levies are categorised differently in the EP study (e.g., as windfall taxes or FATs), and the EP study applies a broader definition of financial transaction taxes that includes stamp duties and capital transfer taxes not specific to the financial sector. Despite these methodological differences, both studies reach broadly consistent conclusions regarding the degree of fragmentation of financial sector taxation across the EU.

The information on each of the national taxes has been compiled in an overview table in Annex 4. At this stage, **92 national taxes targeting specifically the financial services sector have been identified**, excluding the national implementations of regulatory contributions such as the DGS and SRF, unless the latter is linked to a domestic bank levy that is collected independently of the status of the SRF.[289] Other sectoral taxes covered in this analysis are first and foremost indirect taxes, as they generally cover goods and services such as financial transactions, insurance premiums, or assets. Only a few of the identified taxes would classify as direct taxes, namely *additional* corporate income taxes and almost all of the windfall taxes (except Italy), as they tax directly income or profits of the financial services provider. At least 15 national tax measures have been introduced in the previous five years since 2020, indicating that the fragmentation of sectoral taxes placed on the financial sector has been growing since the previous study.[290]

With regards to the development of accumulated tax revenue: while tax receipts from national sectoral taxes appear to have marginally increased in nominal terms from the previous study, in which total tax revenue was estimated at EUR 79 billion in 2017, they have decreased in real terms, when considering inflation over the period. **In 2023, total revenue from 80 tax measures** (where data was available) **was around EUR 82 billion**.

Putting the tax revenue into perspective, revenues from sectoral taxes represent **roughly 12% of the EU gross value added (GVA) of financial activities**, again a slight increase from the 11% measured in 2017. The relative burden on the sector differs very significantly between Member States, with some Member States having no or only a few minor sectoral taxes, to more than 30% of the sectoral GVA in France and Hungary. Similarly, when comparing the tax receipts from sectoral taxes specifically for the financial sector to total tax revenue, notable differences between individual countries become apparent. Across the EU, **revenue from national tax measures on the sector represented close to 2% of total tax receipts** in 2023.[291] Compared to overall GDP, **the total revenue from sectoral taxes accounts for approximately 0.5% of GDP** across the EU. Table 26 below provides an overview of the sectoral taxes by category, showing how frequently they occur and what revenue was generated from them in 2023.

The **majority of identified tax measures are taxes on sales**, among which the Insurance Premium Tax (IPT) is the most widespread, being used in 21 Member States. Almost one-third are financial institution levies, while payroll taxes, financial transaction taxes, additional CIT, and windfall taxes represent a much smaller share. In terms of revenue generation, taxes on sales of financial products contribute over two-thirds of the total, amounting to over EUR 63 billion in 2023 – equivalent to about 9% of the EU GVA for financial and insurance activities. Financial institution levies account for EUR 7 billion (1% of EU GVA), while the other types of tax measures all account for less than 1% of GVA, respectively. Importantly, the list also includes a small number of taxes that only became payable in 2024 or 2025.

[289] The contributions towards the SRF are collected by national authorities, whereby some countries collect them as part of a national bank levy, which is collected independently of the SRF status (i.e. once the SRF is filled, the bank levy is still being collected, albeit at a lower rate). Other countries, however, only collect bank levies for the purpose of filling the SRF, in which case they are not considered a national sectoral tax for the purpose of this analysis.

[290] Cf. AFME (2026), *Bank Taxes in Europe. Examining the effects of banking taxes on banks, the macroeconomy and competitiveness*, report prepared by KPMG, February 2026. Available at: https://www.afme.eu/publications/reports/bank-taxes-in-europe-eu-and-uk/.

[291] Data on total tax revenue per Member State comes from Eurostat and covers total tax receipts in million EUR, excluding social contributions. Eurostat, Main national accounts tax aggregates, last accessed in January 2025.

Table 26. National tax measures by category

Type of tax	No. of Member States with tax in force	No. of taxes identified	No. of taxes with revenue data for 2023 available	Total tax revenue 2023				
				EUR billion	% of total tax revenue	% of GVA of sector[292]	% of GVA of sub-sector[293]	% of GDP
Taxes on the sale of financial and insurance products	21	49	45	63	1.4%	8.9%	-	0.4%
… of which IPT or equivalent	*21*	*40*	*36*	*54*	*1.2%*	*7.6%*	*Insurance 46%*[294]	*0.3%*
Financial institution levies	14	22	20	7	0.2%	1.0%	*Banks* 1.4%	0.0%
Payroll taxes	2	2	2	6	0.1%	0.8%	-	0.0%
Financial transaction taxes	7	7	6	3	0.1%	0.5%	-	0.0%
Additional CIT	5	5	2	0.5	0.0%	0.1%	-	0.0%
Windfall taxes	7	7	5	2.6	0.1%	0.4%	*Banks* 0.6%	0.0%
Total		**92**	**80**	**82**	**1.8%**	**11.6%**		**0.5%**

Source: Taxes in Europe Database, Eurostat National Tax Lists, Targeted Consultation, & previous study

6.2 Taxes on the sale of financial and insurance products

Among the taxes reviewed, **taxes on sales are still the most significant, both in terms of prevalence and revenue generation**. The analysis identified 49 relevant taxes on sales across 21 Member States, with revenue data being available for 45 of the measures. Overall, these taxes generated approximately EUR 63 billion in revenue in 2023. The number of and revenues from these taxes have increased marginally since 2017 when they were estimated at approximately EUR 56 billion, which presents an increase only in nominal terms and not in real terms. No noteworthy new introductions of such taxes occurred in any of the Member States. Figure 58 illustrates the geographic distribution of these taxes and highlights the revenue from indirect taxes as a percentage of national GVA for the financial services sector.

Across Member States, the number of individual taxes on the sale of financial products ranges significantly, as does the revenue generated from them. While some countries (e.g., the Baltics) do not have any such taxation measures for the financial services sector, Italy, Portugal, or Ireland have an array of different measures for specific products. Revenue ranges from as little as EUR 36 million in Malta to over EUR 17 billion in Germany. On average, taxes on sales represent 6% of the GVA for financial activities across the

[292] GVA data from Eurostat, National Accounts, covering financial and insurance activities (Codes 64, 65, and 66).

[293] Some taxes apply exclusively or mostly to specific financial institutions. Hence, a more focused comparison is made with respect to: IPT (GVA of the banking and insurance industry); Financial institution levies and windfall taxes (GVA of banking).

[294] The high percentage reflects the way insurance output is measured in national accounts. GVA for the insurance sector is not based on the full value of premiums written, but rather on the service margin – that is, broadly the difference between premiums received and claims paid, plus investment income. As a result, insurance GVA is substantially lower than total premium income, which forms the tax base for IPTs. The ratio of IPT revenues to insurance GVA therefore appears disproportionately high and should be interpreted accordingly.

EU, with Germany, France, Italy, and Portugal standing out as exceptions where revenue from these taxes accounted for more than 10% of the sector's GVA in 2023.

A substantial majority of these taxes are insurance premium taxes (IPTs), including stamp duties on insurance premiums,[295] implemented in all 21 Member States which tax the sale of financial products. IPTs function as a sales tax charged on the insurance premium paid, without deduction of the associated input costs as in the VAT system, as confirmed by the EUCJ. IPTs also account for a majority of the revenue, generating about EUR 54 billion in 2023[296]. It **accounted for roughly 4-16% of the sector's turnover**, depending on whether it is compared to gross or net premiums[297]. In some cases, IPT rates align or are comparable with the standard VAT rate, though they vary widely across Member States and insurance types (see Box 5 below). In the case of Finland, the direct link between the IPT and the VAT rate has recently been underlined, when the IPT rate was increased in line with the rise of the standard VAT rate from 24% to 25.5%. Generally, rates of IPTs range from as low as 0.1% to as high as 45%. IPTs target first and foremost non-life insurance contracts, with a majority of countries exempting life insurance contracts from their IPT. In five Member States, life insurances are covered by the IPT but at a lower rate, while five countries tax them at the regular rate of IPTs. In the case of Portugal, life insurance contracts are excluded from the stamp duty on insurance premiums but are covered by a specific (lower) fee intended for the national system of civil protection and medical emergency.

Box 5. IPT rates in comparison to standard VAT

As outlined above, some Member States have traditionally aligned their general IPT rates with the standard VAT rates, while others tax insurance premiums at different rates. A comparison between the rates is, however, not straightforward, as many Member States apply a range of rates to different insurance types and do not have what could be considered a standard IPT rate. The following table summarises the IPT rate per Member State and how it compares to the country's standard VAT rate. Where no general IPT rate could be identified, a range of rates is provided – excluding life and health insurances which are often subject to lower rates or excluded from IPT (except for Cyprus, where only life insurance is subject to IPT).

Table 27. IPT rates and standard VAT rates per Member State

MS	IPT rate	Standard VAT rate	MS	IPT rate	Standard VAT rate
AT	11%	20%	**IE**	3%	23%
BE[298]	9.25%	21%	**IT**	21.25%	22%
BG	2%	20%	**LT**	No IPT	21%
CY	1.5% (life)	19%	**LU**	3-5%	17%
CZ	No IPT	21%	**LV**	No IPT	21%
DE	19%	19%	**MT**	11%	18%
DK	1.1% (up to 42.9%)	25%	**NL**	21%	21%
EE	No IPT	24%	**PL**	No IPT	23%
EL	15-20%	24%	**PT**	2-9%	23%
ES	8%	21%	**RO**	No IPT	21%
FI	25.5%	25.5%	**SE**	32-45%	25%
FR	7-30%	20%	**SI**	8.5%	22%
HR	10-15%	25%	**SK**	8%	23%
HU	10-23%	27%			

Source: Indirect taxation on insurance contracts in Europe 2024 (Insurance Europe publication), stakeholders' consultation, TEDB (latest available data, most recent changes in 2025).

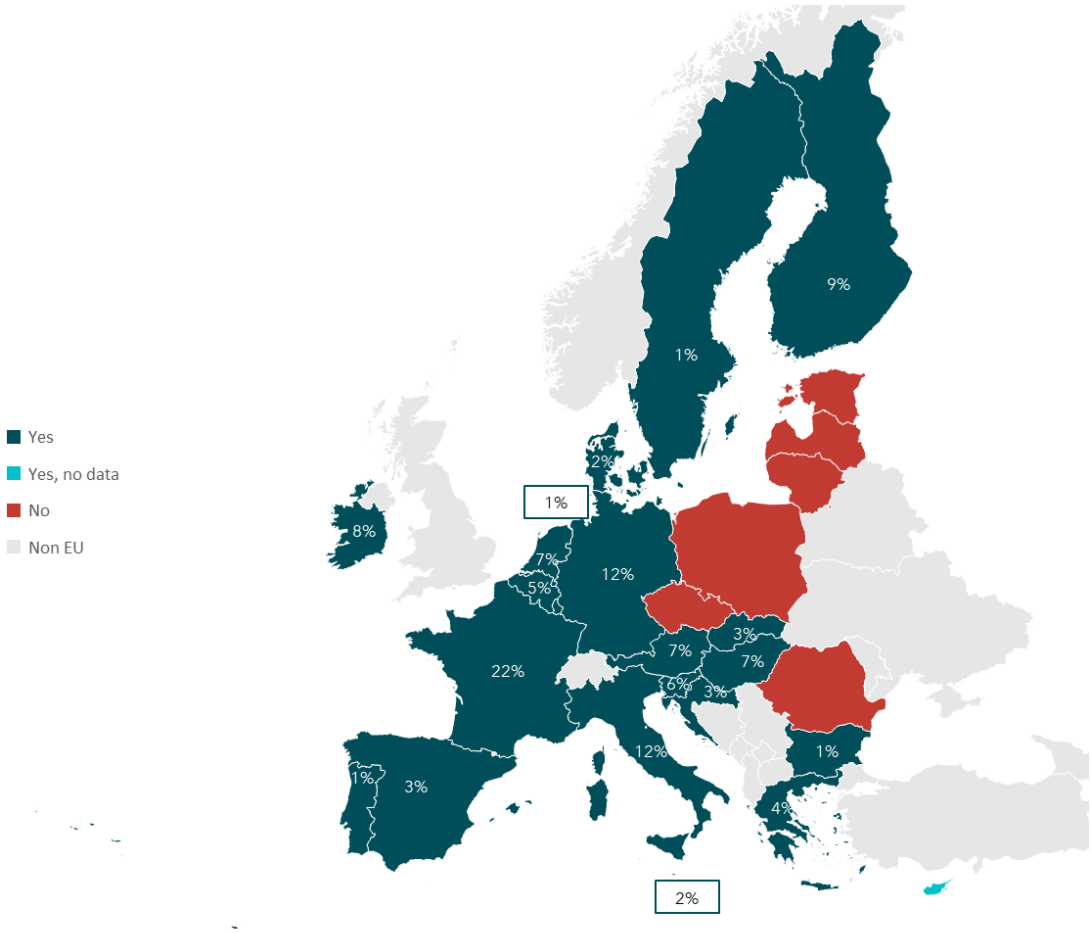
[295] Stamp duties on insurance premiums were counted with IPTs here, in line with the reporting structure of Insurance Europe, as done in their report: *Indirect taxation on insurance contracts in Europe 2024*.

[296] Revenue data are available for 36 out of the 41 IPT measures identified.

[297] Cf. Section 4.4 above.

[298] Starting from 2026, Belgium has increased the IPT rate for most non-life insurance products to 9.60%.

Figure 58. Tax revenue from taxes on sales of financial sector products as proportion of national GVA of financial and insurance activities (2023)



Source: Authors' elaboration based on TEDB, previous study, and Eurostat data

Other taxes on sales include other forms of stamp duties, present in at least three Member States. The tax base for these duties varies considerably. For example, in Ireland, stamp duty applies to credit and charge cards, calculated at EUR 30 per account or card maintained by the bank.[299] In some cases, the tax base may depend on the number of contracts or purchases, such as credit card accounts, while in others it is a tax on insurance premiums such as the case in Portugal. With regard to stamp duties, their design can mirror IPTs, as just highlighted for Portugal, while in other cases they resemble FTTs. The cases, in which stamp duties are similar or equivalent to an FTT are, however, relatively rare.[300] Not least due to this reason, stamp duties are counted as a tax measure in this category, rather than with FTTs, which are described in the subsequent chapter.

As for compliance, the wide range of taxes on sales of certain products has been reported by some stakeholders as a significant burden on their businesses across the EU, particularly in the insurance sector. Insurance companies operating in multiple EU countries not only highlighted instances of double taxation but also emphasised the considerable challenge of navigating different IPT frameworks in each Member State where they operate. This often requires them to rely on local consultants, even for minimal operations in a given country. While some operators expressed a generally positive outlook on the potential abolition of such taxes in exchange for removing the VAT exemption, there remains widespread scepticism among stakeholders about the likelihood of this actually being implemented. This scepticism is further supported

[299] The stamp duty further covers ATM withdrawals (12 cent per withdrawal), which is capped at EUR 2.50 for ATM cards and EUR 5 for combined ATM and debit cards per year.

[300] Cf. European Parliament (2025), *The taxation of the EU's financial sector. Options and experiences*, prepared by Atanas Pekanov and Margit Schratzenstaller from Austrian Institute for Economic Research, prepared for FISC Subcommittee.

by the fact that many such taxes on sales serve specific purposes – for example, in Germany, where the fire protection tax (a type of IPT) is earmarked for funding fire protection measures. This feedback was largely mirrored by respondents providing their views on the possibility of making the availability of the option to tax mandatory. Roughly two-thirds of the consulted stakeholders in the insurance sector seem in support of having the option to tax available, with a few representatives raising concerns over competitive distortion and increasing complexity, while others stressed that their support is limited to a voluntary option that can be chosen on a transaction-by-transaction basis.

6.3 Financial transaction taxes

The analysis identified **seven FTTs in force in seven Member States: Belgium, Greece, Spain, France, Hungary, Italy, and Slovakia** (see Figure 59). Compared to the analysis done during the previous study, this is an increase, with Spain and Slovakia introducing such measures in 2021 and 2025, respectively. These taxes primarily apply to financial service providers, particularly asset managers. The tax base is generally the value of the transactions, such as the value of acquired securities, but the specifics vary widely depending on the financial instruments involved. For example, in Spain and France, the tax only affects the shares in companies with a market capitalisation value in excess of EUR 1 billion, with the tax base being the amount of the consideration, excluding the costs associated with the transaction. Tax rates range from 0.02% to 0.45%. Notably, Hungary and Slovakia apply their FTTs not only to securities transactions but also to payment services more broadly – a specific variant of FTT that targets the full range of financial transactions carried out by resident entities, rather than being limited to capital market activity.

With the exception of Hungary, all Member States in which an FTT was identified are part of a group of countries that had requested to move forward with enhanced cooperation among themselves in the area of FTT, in relation to the 2013 Commission proposal.[301] According to the proposal, an FTT would apply exclusively to the purchase of shares issued by domestic listed companies with a market capitalisation exceeding EUR 1 billion, as in Spain and France. The initial proposal foresaw a minimum tax rate of 0.1% on transactions involving all types of financial instruments, with the exception of derivatives, which would be subject to a minimum tax rate of 0.01%. Despite the growth in the number of countries applying an FTT compared to the previous study, it appears that the popularity of this tax has decreased in recent years, as also indicated by the withdrawal of the official proposal by the European Commission.[302]

Regarding the **tax rates of an FTT**, the Commission proposal is in line with the measures adopted by some Member States, but not all of them. In Italy, for example, the transaction tax applies to share transactions (0.1% of the value of the transactions in regulated markets, 0.2% for over-the-counter transactions), high-frequency trading (0.02%), and derivative contracts (fixed amount, depending on the notional value). In France, the FTT is set at 0.3% on the acquisition of equity securities issued by companies with their registered office in France (provided they are listed on a regulated market and have a market capitalisation exceeding EUR 1 billion). In Greece, the FTT rate is 0.1% since January 2024 (previously 0.2%) and calculated on the transaction value.

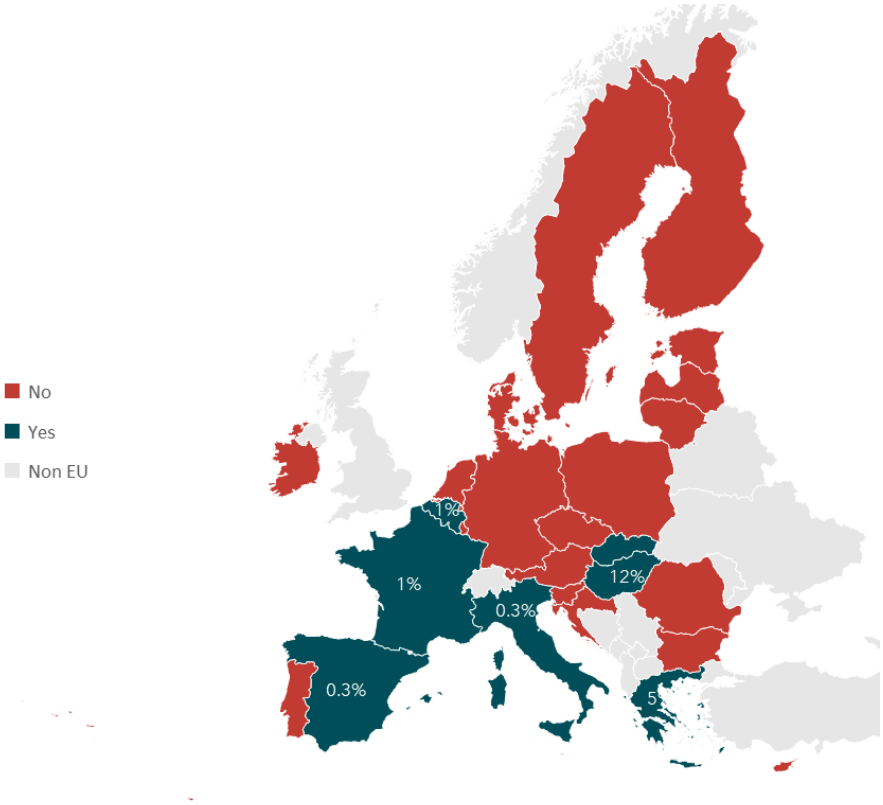
Hungary and Slovakia apply payment-services-based FTTs that go beyond securities transactions. Hungary's financial transaction tax covers both securities and payment services at a rate of 0.45% (increased from the previously reported 0.3%), with a cap of HUF 20,000 (approximately EUR 50) per transaction. The securities tax applies where the underlying securities have a Hungarian ISIN and the transaction is executed on behalf of a securities account holder resident in Hungary for tax purposes. The payments tax applies to a wide range of payment services including bank transfers, direct debits, cash payments from payment accounts (including cash withdrawals using a debit or credit card), cash transfers, debit and credit card payments, and the cashing of cheques. Exchange of foreign currency and debt repayment are also subject

[301] Cf. European Parliament. (2026). Financial transaction tax (FTT). Legislative Train Schedule. Available at: https://www.europarl.europa.eu/legislative-train/theme-an-economy-that-works-for-people/file-financial-transaction-tax; (last accessed in January 2025). See also Commission Staff Working Document accompanying the document Amended Proposal for a Council Decision amending Decision (EU, Euratom) 2020/2053 on the system of own resources of the European Union; SWD/2023/331 final.

[302] Inter alia, this was recently highlighted in a position paper by the European Banking Federation, see EBF (2026), *Modernising the tax framework for financial institutions and financial services*, EBF tax policy paper, advanced version, Brussels, 29 May 2026 available at: https://www.ebf.eu/ebf-media-centre/updates/ebf-tax-policy-paper/ (last accessed May 2026).

to the FTT, even where they are not performed by payment service providers. On 1 October 2024, Hungary additionally introduced a supplementary FTT on certain payment operations involving currency conversion. Slovakia introduced its Financial Transaction Tax effective from April 2025, applying to virtually all financial transactions by resident entities. The tax covers outgoing payments at 0.4% (capped at EUR 40), cash withdrawals at 0.8% (uncapped), card payments subject to an annual fee of EUR 2, and recharged expenses at 0.4% (uncapped).[303]

Figure 59. Tax revenue from FTTs as proportion of national GVA of financial activities (2023)



Source: Authors' elaboration based on TEDB, previous study, and Eurostat data

In 2023, the FTTs collectively generated over EUR 3 billion in revenue, which represents 0.5% of the sector's GVA in that year. As a percentage of the national GVA for financial activities, FTT revenue accounted for about 0.3% in Spain and Italy, 1% in Belgium and France, 5% in Greece, and 12% in Hungary. In absolute terms, France's contribution is the largest, being the only country where tax receipts from the FTT exceeded EUR 1 billion in 2023. Compared to 2017, tax revenue from FTTs has remained stable in France (after a strong increase in 2022, where it was 56% higher than in 2017 and 2023), while increasing in Hungary (+25%) and decreasing in Italy (-15%).

6.4 Financial institution levies

A total of 22 levies on financial institutions were identified across 14 Member States. Figure 60 illustrates the countries with financial institution levies in place and shows the corresponding tax revenues as a proportion of national GVA for financial activities. Almost all of these measures were introduced after the 2007-09 crisis and only a handful of such tax measures have been implemented in the last five years, during which countries like Sweden, Slovenia, and Slovakia instituted bank-specific levies.

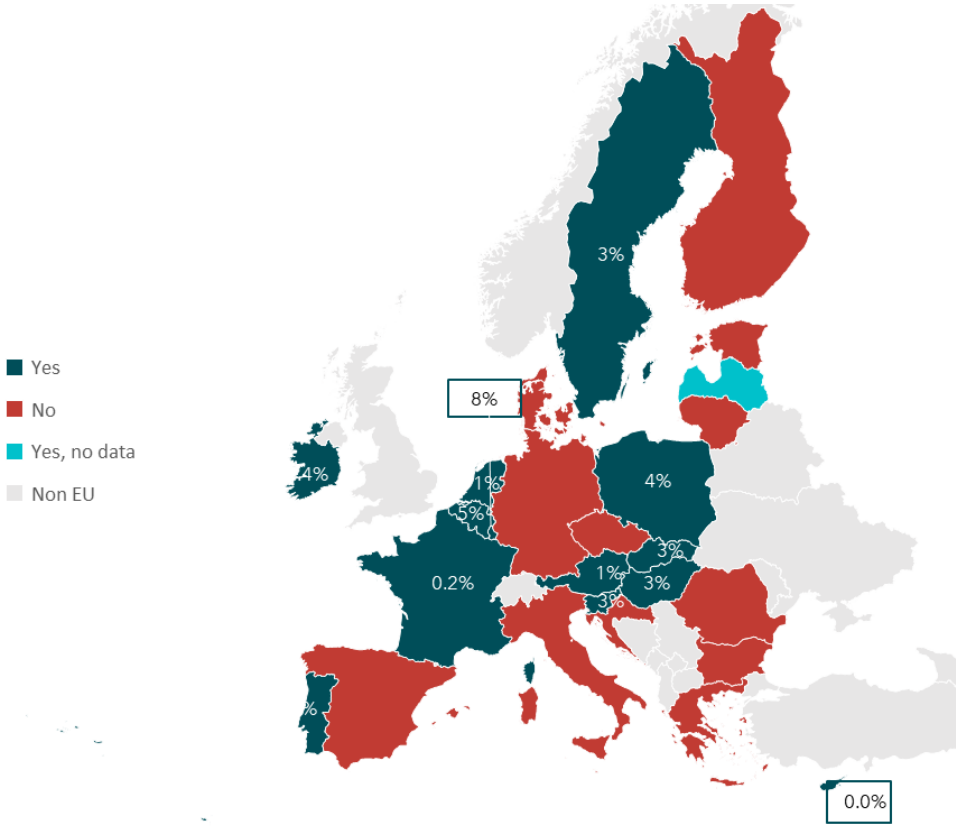
Typically, the levy is calculated on specific components of financial institutions' balance sheets. For example, in Austria, the levy on banks is set at 0.024–0.029% of balance sheet totals, after deducting secured deposits, equity, and trust transactions. The rates of these levies vary significantly, although the majority fall below 1%. In rare cases, the levy can also take the form of fixed amounts. Similar to IPTs, some

[303] Current version of legislation: https://www.slov-lex.sk/ezbierky/pravne-predpisy/SK/ZZ/2024/279/; last accessed in May 2026. (last accessed March 2026)

Member States have several different levies specifically targeting financial institutions, as is the case in Belgium and Portugal. In Belgium, these include an annual tax on unit trusts, credit companies, and insurance companies, as well as an annual tax on credit institutions. Portugal introduced a so-called solidarity contribution on the banking industry in 2020, adding to a list that already includes a bank-specific contribution and regulatory fees on financial institutions and insurance companies. While it is mostly credit institutions or financial institutions at large that are subject to these levies, there are a few select tax measure specifically affecting funds, such as the so-called subscription tax in Luxembourg.

Importantly, taxes on financial institutions remain a popular tool for governments across the EU to address funding of public budgets. This has been illustrated recently in Austria and Belgium, which have increased existing levies and / or introduced additional ones.[304]

Figure 60. Tax revenue from levies on financial institutions as proportion of national GVA of financial activities (2023)



Source: Authors' elaboration based on TEDB, previous study, and Eurostat data

In terms of revenue, 18 of these levies generated approximately EUR 7 billion in total, representing 1% of the EU's GVA for financial activities. On average, revenue from these levies accounted for 3% of national GVA in this sector, ranging from less than 1% in Ireland to 8% in Luxembourg. The highest total revenue from financial institution levies was recorded in Belgium, where the combination of levies raised over EUR 2 billion in 2023. In addition to the already relatively high burden on Belgian financial institutions, the bank levy is set to be further increased between 2026 and 2029.[305] Revenue trends between 2017 and 2023

[304] More information on the reforms of the Austrian government: https://wts.com/global/publishing-article/20250505-austria-new-government-program-is-addressing-tax-changes-for-the-finantial-services-sector~publishing-article; (last accessed March 2026)
More information on the reforms of the Belgian government: https://www.ejustice.just.fgov.be/eli/wet/2023/12/22/2023048600/staatsblad. (last accessed March 2026).

[305] The Belgian government will implement an increase of the banking tax for the years 2026, 2027, 2028, and 2029, see: https://www.belgium.be/sites/default/files/resources/publication/files/Regeerakkoord-Bart_De_Wever_nl.pdf (last accessed March 2026); and: https://www.brusselstimes.com/1894521/belgian-government-approves-new-tax-measures-aimed-to-reduce-mounting-debts. (last accessed March 2026).

varied significantly. In some cases, tax revenue has declined notably, such as Austria's bank levy (-57%) or Ireland's bank levy on DIRT accounts (-44%). Conversely, revenue increased starkly in other instances, most prominently Belgium's annual tax on unit trusts, credit companies and insurance companies (+47%),

Since 2016, in addition to national bank levies, certain financial institutions have been required to contribute to the **SRF** at the EU level. In limited cases, the contributions to the SRF were incorporated into the domestic bank levy with funds subsequently flowing onwards to the SRF. The implementation of the SRF contributions and national equivalents is discussed further in Section 8.2 below.

6.5 Payroll taxes

Payroll taxes specific to financial institutions continue to be a less common tax measure, with only two such taxes identified – in Denmark and France. These taxes target providers of VAT exempt or out of scope services. In both cases, the tax base is the remuneration of employees. Denmark applies a flat rate of 15.3% (since 2021, up from 15%), while in France, the base includes salaries and all benefits in kind, with a progressive tax rate ranging from 4.25% to 13.6%.

In 2023, payroll taxes from the financial sector in France generated about EUR 4-5 billion,[306] which corresponds to about 5.5-7% of the national GVA for financial activities. In Denmark, payroll taxes brought in approximately EUR 1.5 billion, accounting for 8% of the national GVA for the sector, with revenues increasing sharply between 2017 and 2023 (+80%).

6.6 Additional corporate income taxes

Since the previous study, **four Member States have introduced a higher rate of corporate income tax (CIT) for banks**. To date, the number of identified additional CIT tax measures are limited to the four cases of Denmark, Lithuania, Latvia, and Romania. However, **Italy has a similar tax measure in place**, applying a higher regional production tax (IRAP) rate on banks and insurances. Although this is not a corporate income tax per se but rather taxes a company's added value (i.e. profit and cost of labour), it is being included here as well. Limited data on tax revenue from this type of sectoral tax is available at this stage, due to the tax only coming into force in 2024 in both Latvia and Romania.[307] Counting the tax measures in Lithuania and Italy, revenue from such additional tax rates has accounted for slightly over EUR 500 million in 2023, and is hence negligible at less than 0.1% of EU GVA of the financial sector. Lithuania introduced this additional CIT in 2020, imposing an extra 5 percentage points on banks' taxable income, raising their CIT rate from the standard 15% to 20% - and from 17% to 22% starting from 2026.[308] In 2023, the tax receipts from just the additional 5% were around EUR 60 million, equalling about 2% of the GVA of the domestic financial activities. Latvia followed suit in 2024, though with a different system that applies a 20% surcharge on profits from the previous year, using the net profit of the pre-taxation year as the tax base. In Romania, the turnover of credit institutions has been taxed with an additional 2% since 2024, a rate that will drop to 1% starting from 2026. Italy, on the other hand, has had this tax in place since the 1990s, and is currently levying 4.65% on banks and 5.90% on insurances, as opposed to the 3.9% standard rate. Revenue from the additional IRAP in 2023 was placed at close to EUR 500 million, accounting for less than 0.5% of the GVA produced by the Italian financial sector.

In Lithuania, the additional CIT was initially introduced as a temporary measure but was made permanent in July 2022. The legislation specifies an additional 5% tax on financial institutions with annual profits exceeding EUR 2 million, following a decision by the Constitutional Court confirming the legality of the measure. Stakeholders from the financial industry noted that authorities had partly justified this additional

[306] Estimate provided by French authorities, based on overall tax receipts from the payroll tax amounting to almost EUR 17 billion in 2023. This includes the tax revenue from all sectors that are liable to pay payroll tax (*taxe sur les salaires*), including the public education and healthcare sectors. An exact revenue figure for just the financial and insurance sectors was unavailable.

[307] According to the EP Study, the tax revenue from this measure amounted to roughly EUR 140 million in Latvia in 2024 and to EUR 160 million in Romania.

Cf. European Parliament (2025), *The taxation of the EU's financial sector. Options and experiences*, prepared by Atanas Pekanov and Margit Schratzenstaller from Austrian Institute for Economic Research, prepared for FISC Subcommittee.

[308] The standard CIT rate was increased to 17% starting from 2026 in Lithuania. The additional 5% for credit institutions was maintained, putting their rate at 22% now, see: https://taxsummaries.pwc.com/lithuania/corporate/taxes-on-corporate-income (last accessed March 2026).

tax by referencing the VAT exemption for financial institutions. However, this reasoning was not explicitly confirmed by authorities during consultations, leaving some ambiguity about its relation to the VAT exemption.

Finally, Denmark has started to impose a higher CIT rate on financial institutions – covering banks and insurance companies – in 2023. While the regular CIT rate in Denmark is set at 22%, financial institutions had to pay 25.2% in 2023 and then 26% starting from 2024. The measure was introduced as a way to finance a bill on early retirement and appears to be a permanent measure.[309] No separated revenue data could be retrieved only for the surcharge on financial institutions.

6.7 Windfall taxes

Potentially the most significant change in the area of sectoral taxes for the financial sector has been the rise of so-called **windfall taxes,** specifically targeting banks. **A total of seven windfall taxes in seven Member States[310]** have been identified so far, based on how national governments identified or justified these measures. However, in a number of cases, these taxes, albeit introduced at a time in which financial institutions' profits had increased for exogeneous reasons, do not always have 'extra' profits as their taxable basis. Also, in some countries they have seemingly become a permanent tax that can apply regardless of profit levels. This brings these measures closer to 'standard' sectoral taxes, such as bank levies or additional rates on banks' CIT.

The rationale underlying windfall taxes is that a specific sector or group of companies experiences a sudden influx of windfall gains due to unforeseen circumstances, which are then targeted specifically by a tax introduced ex post, whose tax basis consists of above average or excessive profits. First used in the US, windfall taxes were applied to banks as early as the 1980s, when the UK introduced them to tax banks benefitting from high interest rates[311].

Windfall taxes first entered the policy debate in the EU in the aftermath of the Russian war on Ukraine and the subsequent sanctions against Russia, contributing to increasing energy prices and above-average profits for energy companies. The events led the Commission to discuss the option of introducing windfall taxes on energy providers[312]. The suggestion was to consider such as taxes temporary to be able to partially offset heightened energy bills, but that they should 'not be retroactive, […] be technologically neutral and allow electricity producers to cover their costs and protect long-term market and carbon price signals'[313]. With the solidarity contribution, a form of EU-wide windfall tax was subsequently introduced for the fossil fuel sector. According to the relevant Council Regulation, Member States are obliged to introduce a temporary tax – or keep an equivalent national measure compatible with the objectives of the regulation – on excessive profits (i.e., above a 20% increase of the average annual taxable profits since 2018), but only for the fiscal years 2022 and/or 2023[314]. The idea was then extended by some Member States to the banking sector, which enjoyed above-average profits for different reasons, i.e., rising ECB interest rates, to fight

[309] Cf https://taxsummaries.pwc.com/denmark/corporate/significant-developments; Cf also https://kromannreumert.com/en/news/higher-corporate-tax-rate-the-danish-financial-sector-and-cap-on-deductibility-of-salary; (last accessedJuly 2025).

[310] Czechia, Spain, Hungary, Italy, Latvia, Lithuania, and Slovakia have introduced such measures.

[311] Tax History Project (2005), *Historical Perspective: The Windfall Profit Tax -- Career of a Concept*, available at: https://www.taxnotes.com/tax-history-project/historical-perspective-windfall-profit-tax-career-concept/2005/11/15/y8g5; (last accessed in September 2024).

Abdul-Salam, Y. (2024), *Examining the effect of the UK oil and gas on the economics of new fields in the UKCS province*, in: Resources Policy, Vol. 88, available at: https://www.sciencedirect.com/science/article/abs/pii/S0301420723011583?fr=RR-7&ref=pdf_download&rr=8c066b43ca805a3b; (last accessed in September 2024).

[312] Press Conference on the REPowerEU communication, available at: https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_22_1632; last accessed in September 2024.

[313] Communication from the Commission, REPowerEU: *Joint European Action for more affordable, secure and sustainable energy*, Strasbourg, 8.3.2022, COM (2022) 108 final.

[314] Council Regulation (EU) 2022/1854 of 6 October 2022 on an emergency intervention to address high energy prices.

inflation (which was provoked inter alia by the surge in energy prices, and the resulting higher interest rate margins).[315]

The two most prominent examples of windfall taxes are those introduced in Italy and Spain, both of which prompted the ECB to issue opinions (discussed in more detail further below, as well as in Box 25 and chapter 8.1). In Spain, the windfall tax was introduced in 2022 and initially intended to be valid only for 2023 and 2024 but was eventually extended at least until 2027. It applies to financial institutions whose interest and commission income exceeded EUR 800 million in 2019, with the tax base being net interest income and net fees and commission income, taxed at a rate of 4.8%. For the years 2025-2027, the tax was adjusted to a progressive model going from 1% to 7%, whereby a 7% tax rate is faced by the largest banks with an annual revenue exceeding EUR 5 billion. **Notably, the Spanish windfall tax does not explicitly target excessive or windfall profits** but resembles a levy on the margin of large financial institutions. In 2023, Italy followed with a one-off windfall tax to be paid in 2024.[316] Unlike Spain, Italy defined windfall profits explicitly, taxing the portion of the 2023 interest margin exceeding the 2021 interest margin by more than 10%, at a rate of 40%. The payable amount was capped at 0.26% of risk-weighted assets. Alternatively, banks could increase their capital by at least 2.5 times the additional tax amount, an option reportedly chosen by all affected banks, resulting in negligible additional tax revenue.

Windfall taxes in other Member States feature varying designs. Hungary introduced a broad windfall tax in 2022 covering several sectors, including banking. Initially, the tax base was 100% of the previous year's pretax earnings, later reduced to 50%, with rates currently set at 8% on tax bases not exceeding HUF 20 billion and 20% applying to excess amounts. Like Spain, **Hungary has extended its windfall tax at least until 2026**. In **Czechia and Lithuania, windfall taxes were implemented in 2023** with notable differences. Czechia's tax applies a 60% rate on profits exceeding 120% of the average profit from 2018–2021, valid until 2025. Lithuania uses a similar 60% rate but applies it to net interest income exceeding a four-year moving average by 50%. The base years for the average were initially set for 2018-21, then moved to 2019-22 for 2024, but were frozen for 2025 (i.e., staying at 2019-22 and not sliding further forward). The Lithuanian tax has expired in 2025. Even though stakeholders had raised concerns about potential extensions, there is currently no information indicating that the windfall tax will apply in 2026.

Latvia and Slovakia are the latest adopters of windfall taxes on banks. Slovakia's tax entered into force in 2024, with a declining rate starting at 30% of net profits and reaching 15% by 2027. Like Spain, Slovakia's tax does not specifically target excessive profits and has no definitive end date. Latvia's tax mirrors Lithuania's with a 60% rate on net interest income exceeding the 2018–2022 average by 50%, but it includes new loans, unlike the Lithuanian model, where they were excluded upon concern of negative impacts on the loan market.

Revenue data from 2023 shows an estimated EUR 2.6 billion collected from Czechia, Hungary, Italy, Spain, and Lithuania, representing 0.4% of the EU-wide GVA for the sector. Latvia and Slovakia introduced their measures after 2023, which is why no revenue data has been collected from these countries. Spain accounted for the majority, with EUR 1.7 billion, equating to 2% of its national GVA for financial and insurance activities. The Hungarian and Lithuanian revenue is larger in relative terms, reaching 10% and 5% of domestic GVA, respectively. The Czech windfall tax generated notably lower revenue, accounting for less than 0.3% of the financial sector's GVA in the country. Italian revenue, as mentioned, was minimal at EUR 9 million.

[315] Cf. Tax Foundation (2023), *Windfall Profit Taxes in the EU*, available at: https://taxfoundation.org/data/all/eu/windfall-tax-europe-2023/; last accessed in September 2024.

[316] According to Art. 26 of Decree 104 from 10 August 2023, the extraordinary tax is established only for the year 2023, to be payable until 31 January 2024. As such, the tax is designed as a one-off payment and has not been renewed at the time of writing.

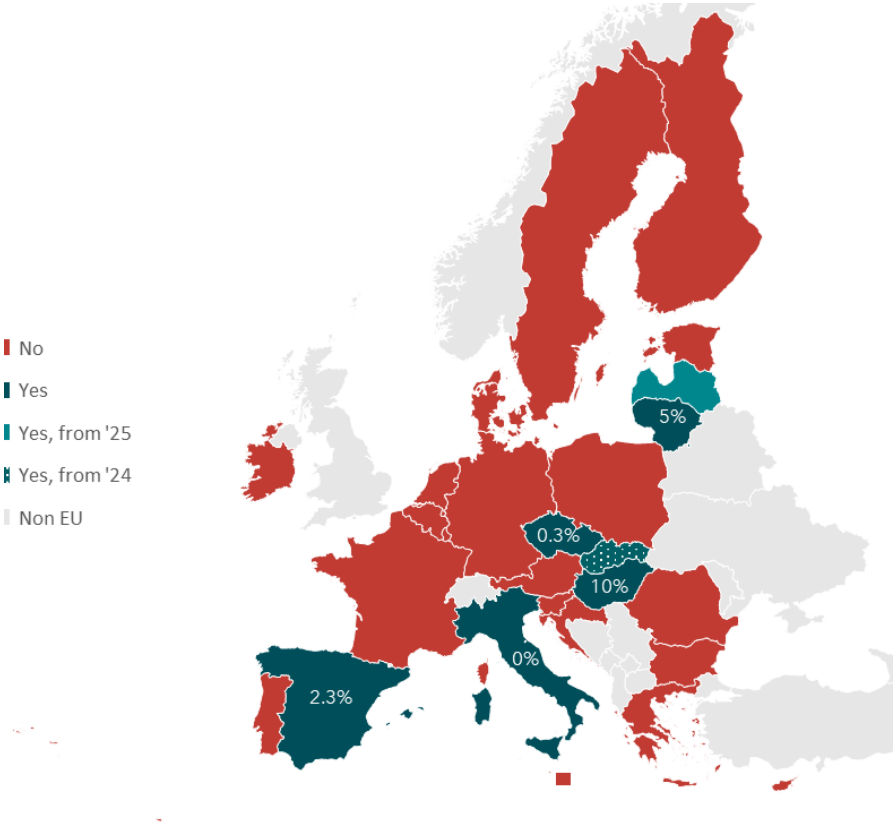
Table 28. Windfall taxes in EU Member States

Member State	Tax revenue from windfall tax (2023)			
	EUR million	% of national tax revenue	% of GVA of financial sector	% of GVA of banking sector
Czechia	25	0.04%	0.26%	0.31%
Spain	1,695	0.5%	2.3%	2.9%
Hungary	690	1.4%	9.7%	12.9%
Italy	9	0.00%	0.01%	0.01%
Lithuania	164	1.0%	5.1%	6.6%
Latvia	*Introduced 2025*	-	-	-
Slovakia	*Introduced 2024*	-	-	-

Source: Eurostat National Tax Lists, Targeted Consultation, and Eurostat

While there is limited evidence on the broader impact of these taxes on banks' competitiveness or business models, Lithuanian stakeholders noted some negative effects on sectoral fragmentation but acknowledged that strong bank profits in 2023 allowed for the absorption of the tax burden by the banks without passing it on to consumers.

Figure 61. Tax revenue from windfall taxes as proportion of national GVA of financial activities (2023)



Source: Authors' elaboration based on TEDB, previous study, and Eurostat data

The ECB raised several concerns regarding the design of these taxes. From a financial stability perspective, such taxes reduce retained earnings, limiting credit institutions' ability to build capital buffers and withstand economic shocks, potentially deteriorating credit quality. A lack of EU-wide coordination risks fragmenting the financial system, distorting competition, and creating double-taxation issues for internationally active banks. In line with previous opinions voiced on bank levies, the ECB reiterates that the generated revenue from such extraordinary measures should be isolated and not used for general

budgetary purposes.[317] From a monetary policy perspective, these taxes could also impair banks' ability to maintain adequate capital and provisions, particularly during downturns, thereby disrupting monetary policy transmission. Fiscal measures should be temporary, targeted, and focused on supporting vulnerable households and businesses to avoid inflationary pressures and inefficiencies. Regarding prudential supervision, these taxes disproportionately affect smaller, lending-focused institutions, which are more vulnerable to economic fluctuations, underscoring the importance of maintaining strong capital positions to ensure resilience. [318] In its opinion on the Lithuanian windfall tax, the ECB raises very similar points, highlighting also the risk of market fragmentation and potentially distorted competition, though acknowledging that the tax's design makes efforts to target specifically windfall profits and to avoid harming credit institutions' resilience.[319]

Similar caution has been expressed by other international institutions. In particular, the IMF has emphasised that taxes on excessive profits should be implemented carefully, noting that elevated bank profits observed in 2022 and 2023 were expected to decline and that European banks continue to face structural and regulatory challenges.[320],[321]

6.8 Summary

Unlike the VAT exemption, which varies by country only according to the details of implementation, **approaches to sectoral taxes are much more fragmented**, reflecting national priorities and fiscal strategies. The analysis identified six categories of tax and 92 specific measures in force. Moreover, the trend is for increasing fragmentation, with 15 new taxes introduced in the last five years, and ad hoc windfall taxes becoming more widespread.

The **revenue from these taxes is significant, totalling EUR 82 billion in 2023**[322], making for more revenue than the EUR 70 billion liability from VAT estimated for the sector. The majority of the revenue – EUR 54 billion – comes from insurance premium taxes (IPTs). These are by far the most common type of tax, being applied in 21 Member States, as well as the one most directly used to compensate for the VAT exemption. Adding other indirect taxes on the sale of financial and insurance products takes the total to EUR 63 billion, i.e. over two thirds of sectoral tax revenue. Financial institution levies, introduced primarily after the 2007–09 crisis, account for a smaller but still substantial share of tax revenue. These levies, typically calculated based on specific components of institutional balance sheets, vary greatly in their rates and design. FTTs, though less common, have grown in importance, particularly in Member States like Belgium, Hungary, France, Slovakia, and Spain. Windfall taxes, a newer category, have gained attention in response to extraordinary market conditions, in particular rising interest rate margins, and have been introduced in seven Member States.

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[317] Cf also: ECB, Opinion of the European Central Bank of 26 November 2019 on increasing the special levy on selected financial institutions, CON/2019/40. Specifically paragraph 2.1, referenced in the opinion on the Spanish windfall tax, where the ECB states: 'The proceeds from taxes on financial institutions should be ring-fenced to avoid their use for general fiscal consolidation purposes'.

[318] Cf ECB, Opinion of the European Central Bank of 2 November 2022 on the imposition of temporary levies on certain credit institutions, CON/2022/36; ECB, Opinion of the European Central Bank of 12 September 2023 on the imposition of an extraordinary tax on credit institutions, CON/2023/26.

[319] ECB, Opinion of the European Central Bank of 4 April 2023 on the imposition of a temporary solidarity contribution, CON/2023/9.

[320] Maneely, M. & Ratnovski, L. (2024), *Bank Profits and Bank Taxes in the EU*, in: IMF Working Paper, WP/24/143, July 2024.

[321] Stakeholder organisations have raised comparable concerns. For example, the European Banking Federation (EBF) has argued that there is no common methodology for defining or calculating 'excessive' profits and warned that an uncoordinated proliferation of national windfall taxes could undermine the Single Market and the Savings and Investment Union. In: EBF (2026), Modernising the tax framework for financial institutions and financial services, EBF tax policy paper, advanced version, Brussels, 29 May 2026 available at: https://www.ebf.eu/ebf-media-centre/updates/ebf-tax-policy-paper/ (last accessed May 2026).

[322] Revenue data are available for 80 out of 92 tax measures identified.

7. Economic analysis of the tax framework for financial services

This chapter examines the economic effects of the existing tax framework for financial services. The analysis takes several perspectives, as follows:

- Section 7.1 focuses on the VAT exemption, and the impacts of different approaches to applying the structural provisions of the regime, mainly whether and how to allow the option to tax, VAT groups and cost-sharing arrangements (CSAs), differing rules for calculating the proportional deduction, and the scope of certain service definitions.
- Section 7.2 assesses the costs for different types of financial services providers, and tax authorities for complying with and enforcing the VAT exemption sectoral taxes. For the VAT exemption, the analysis considers specific aspects of the regime (e.g. administering a VAT group, calculating proportional deductions) as well as litigation costs, and compares these to what would be expected were the general VAT rules to be applied instead.
- Finally, Section 7.3 considers the broader consequences of the tax framework in terms of competitiveness (i.e. impacts on business performance), trade on the Single Market and implications for competition with firms based abroad.

7.1 Economic impacts of different approaches to VAT rules for the financial services

This section examines the quantitative effects of differences in the national implementation of the VAT rules for financial services. The methodology relied on the following approach:

- Identifying cross-country or temporal variations which could be used to test empirical hypotheses;
- Verifying the availability and quality of data and, on this basis, deciding on which Member States to focus on;
- Identifying the most suitable dependent variables;
- Quantitatively assessing difference in conditional means or other statistical estimates, based on the results of the VAT analysis presented in Chapter 5

Box 6 below provides more detail on the methodology applied, while Table 29 presents the issues analysed and those which could not be assessed, due to the lack of sufficient data.

Box 6. Methodology for the estimation of impacts of the current VAT rules

To test alternative hypotheses regarding the impact of different provisions, sectoral and cross-country differences in the VAT treatment of financial services (the independent variables) were analysed against a set of indicators (the dependent variables). The list of indicators includes: (1) share of taxable output of the financial sector over total output of the financial sector; (2) the ratio between deductible input VAT to total output of the financial sector; (3) the ratio between non-deductible input VAT and total output of the financial sector. Each of these indicators was calculated based on tax return data submitted from 18 Member States. They were also calculated separately for NACE categories 64, 65, and 66. In addition, to test the hypothesis on the impact of VAT treatment of asset-management services, we used data from Eurostat's use tables (NAIO_10_cp16), which describe the interlinkages of the NACE 66 sectors with all financial subsectors. Aligned with the vintage of the VAT analysis, data refer to 2023.

Table 29. Impact of current VAT rules – Issues analysed

Provision	Scope	Dependent variable	Hypothesis tested	Data availability
Option to tax	Cross-country	Share of taxable output	Option to tax increases share of taxable output	Ok
			Wide option to tax increases share of taxable output	Ok
			Transactional option to tax increases share of taxable output	Ok
	Temporal		Introduction of option to tax in PL increases share of taxable output	Ok
			Introduction of transactional option to tax in FR increases share of taxable output	No. Administrative VAT data not available – change too recent for impacts to emerge
VAT groups and CSAs	Cross-country	Amount of hidden VAT saved, outsourced supplies	VAT groups /CSAs reduce (i) non-deductible VAT (ii)outsourced supplies[323],	Ok
	Temporal		Introduction of VAT groups in PL / IT / FR reduces non-deductible VAT, outsourced supplies	No. Not possible to measure differences in non-deductible VAT across time.
CSA	Cross-country	Non-deductible VAT	CSAs reduce non-deductible VAT	No. Use of CSAs declined even in countries where allowed; parallel introduction of VAT groups
Proportional VAT deduction rules	Cross-country	Input VAT deducted	Different national regimes affect input VAT deducted	Ok
Definitions on the VAT treatment of asset-management services	Cross-country	Supplies from other financial services to other financial companies	Broader interpretation of the exemption encourages outsourcing to third-party asset managers	Ok

7.1.1 Option to tax

In principle, the introduction of the option to tax should increase the proportion of taxable outputs to the total outputs of the financial services sector because some operators would be expected to start charging VAT to customers where the latter has a right to deduct. However, the analysis shows only **limited to**

[323] i.e., inputs provide to a financial institution by an external entity.

negligible impacts on the share of taxable output. This confirms the evidence from the targeted consultation, suggesting that the option to tax is either not widely used, or it is more often used by smaller financial institutions, generating savings that are limited compared to sectoral turnover and input costs.

When comparing 'wide' or 'transactional' approaches to the option to tax, the sign of the change aligns with the hypothesis tested, i.e. that the exercising of the option to tax increases the proportion of taxable outputs, at least for the banking sector. However, the change is so small that it is not significant, in the order of 1pp increase in the share of taxable outputs. When considering the introduction of the option to tax in any form, of the share of taxable outputs to total outputs is statistically very close, but actually *lower* in countries that do not have the option to tax, running against the tested hypothesis.

Table 30. Share of taxable output in countries with or without option to tax

	K64	K65	K66	Total
No option to tax	30%	4%	34%	23%
Option to tax	27%	2%	28%	19%
Option to tax narrow	26%	2%	22%	17%
Option to tax wide	27%	1%	34%	21%
Option to tax non-transactional	27%	2%	32%	20%
Option to tax transactional	27%	2%	21%	17%
All Member States	**29%**	**3%**	**32%**	**21%**

Source: Authors' elaboration based on VAT Liability Analysis

An analysis has also been done on the effects of the introduction of the option to tax in Poland. Comparing data from 2018 to 2023, the output of the financial services sector increased by about 100%, while taxable output increased by nearly 300%, similarly to the increase in deductible input VAT. However, given that output VAT in the sector remains small compared to exempt output, the growth is limited in absolute terms. The different growth in the two variables can be partly explained by the introduction of the option to tax, which would indeed result in the *taxable* output outpacing the growth of *total* output. Importantly, and in line with the findings of the consultation, only a small share of these savings accrued to banks, which have hardly opted for VAT; about two thirds of the additional taxable output occurred indeed in the other financial services sector, i.e., asset and fund management.

7.1.2 VAT grouping and CSAs

By eliminating input VAT on intra-group supplies, VAT groups and CSAs should generate benefits for service providers in the form of reduced hidden VAT. The analysis shows this effect to be evident in practice. More specifically, they do not create benefits when it comes to intra-group supplies of financial services; while making up a big proportion of intra-group supplies, these are exempt anyway. Rather, these groups serve to eliminate VAT on the supplies of other intra-group services such as IT, accounting, tax, legal, back-office, and location management, which would otherwise be taxed.

The impacts of the VAT grouping on financial service providers' behaviour and deduction rate cannot be disentangled from that of CSAs, because in all countries in which CSAs can be adopted, VAT grouping is also available. Hence, the following estimates concern the availability of either mechanism to address non-deductible VAT on intra-group supplies.

This is assessed over two variables:

1. Share of inputs other than financial services over output value (from VTTL). Since the SUT does not account for intra-group and intra-company transactions, in countries in which VAT grouping or

CSAs are not available, the share of inputs other than financial services over output value should be higher[324].

2. Share of deductible input VAT over total output (from the fiscal data provided by tax authorities during the targeted consultation). In countries in which VAT grouping or CSAs are available, non-deductible VAT should be lower, as measured by the above ratio.

For the purpose of the analysis, countries without VAT grouping and CSAs include Bulgaria, Croatia, Greece, Lithuania and Romania, as well as Slovenia, in which they apply from 2026.

The findings are consistent with the hypotheses and across the two parameters. More in detail, the share of inputs other than financial services over output value is higher in the six countries by 4 pp. (31% vs. 27% in the other Member States);. The same goes for the share of non-deductible input VAT over output VAT by 1.0 pp. (4.1% vs. 5.1% in the other Member States). These two results are also consistent, since 4% of additional inputs would correspond to about 0.9 pp. of difference in input VAT (compared to the 1.0 pp. of differences found). In both cases, differences are starker for the insurance and asset manager sectors, while less so for banks, which have a higher share of input VAT over output VAT (by 0.6 pp.), but a slightly lower share of inputs other than financial services over output value (29% vs 28%). Full results are shown in Table 31 below.

Table 31. Impacts of CSAs and VAT grouping on outsourcing, non-deductible VAT

		Banking	Insurance	Other financial services	Total
Other intermediate inputs as % of output value	No CSAs, VG	28%	33%	33%	31%
	CSAs and/or VG	29%	24%	28%	27%
Input VAT deducted to output VAT	No CSAs, VG	5.4%	0.1%	7.0%	4.1%
	CSAs and/or VG	6.0%	1.0%	8.3%	5.1%

Source: VTTL, data from tax authorities

Another approach was used to estimate the impacts of VAT groups in the current situation. This entailed defining assumptions on the values of taxable intra-group supplies eliminated by VAT groups, which would then serve to reduce hidden VAT. Three scenarios have been considered, with intra-group input supplies that would otherwise be taxable set at 10%, 20% and 40% of total input supplies (excluding investment).

Based on these scenarios, **in the 21 Member States where VAT groups are available[325], they save between EUR 4 and 16 billion of non-deductible VAT. This corresponds to 0.3% and 1.2% of sectoral turnover.** Making a similar calculation, the introduction of VAT groups in the remaining seven Member States would reduce non-deductible input VAT (as it is no longer charged on intra-group supplies) by about EUR 160 to 660 million, corresponding to 0.2 – 0.8% of the sectoral turnover. **The gains are most pronounced for the insurance sector, generating 60% more savings than the banking and other financial services sector.** This is because insurance providers make almost exclusively exempt supplies and hence can deduct very little of the input VAT they incur.

[324] The mechanism is as follows: supplies of financial services are largely VAT-exempt, meaning that financial services providers cannot recover VAT on their purchases. Any input acquired from an external supplier therefore carries an irrecoverable VAT cost. Where VAT grouping or CSAs are available, however, a provider can obtain the same inputs – back-office processing, IT infrastructure, compliance functions, and similar services – from an intra-group entity free of VAT, since transactions within a VAT group or covered by a CSA fall outside the scope of VAT. This creates a strong incentive to internalise such functions into group entities. The result is that more non-financial inputs appear as recorded external purchases in the national accounts, inflating the measured ratio of non-financial inputs to output relative to what would be observed in countries where these arrangements are unavailable.

[325] VAT groups are currently available in 22 Member States. In this analysis Slovenia is not included as VAT groups were only introduced in January 2026.

Table 32. Reduction of hidden VAT due to VAT groups (EUR mn)

	Hidden VAT savings (mn EUR)			% of turnover		
	Banking	Insurance	Other financial services	Banking	Insurance	Other financial services
Scenario 1 - 10% of intra-group supplies	2,040	1,530	750	0.3%	0.4%	0.3%
Scenario 2 - 20% of intra-group supplies	4,090	3,060	1,490	0.5%	0.8%	0.5%
Scenario 3 - 40% of intra-group supplies	8,170	6,120	2,980	1.0%	1.6%	1.0%

Source: Authors' elaboration on own assumptions, VTTL, data from tax authorities

7.1.3 Proportional VAT deduction

As explained in Section 3.1.6 above, Member States can be classified into four families when it comes to proportional VAT deduction: (i) general pro rata; (ii) pro rata; (iii) actual use; and (iv) liberal. The analysis tested the extent to which input VAT deduction rates (measured as a ratio between input VAT deducted and output VAT) varies across these four 'families'. Member States with a significant proportion of 'exports' of financial services to non-EU countries were excluded from the analysis, since these supplies are zero-rated and could have overshadowed the impacts of differences in the deduction rules.

The analysis shows no significant differences for the insurance sector, which is the industry with the lowest share of taxable outputs, and hence of input VAT deduction; the proportion of input VAT deducted over output VAT varies in a narrow range of about 2pp (0.3-2.5%). The difference is however significant for banking and other financial services. **For the banking industry, the share of input VAT deducted is significantly lower for countries with actual use deduction methods (1%) compared to countries with any other method, in which the ratio of input VAT deducted clusters around 6-7%. Similar results were found for the other financial services sector,** with countries using the actual use approach showing lower levels of deductibility; for this sector, also countries with a liberal approach to pro-rata calculations tend to have lower deduction rates. Detailed results are shown in Table 33 below.

Table 33. Levels of deduction across different approaches to proportional VAT deduction

Level of deduction	- Banks	Insurance	Other financial services	Total
Actual Use	1%	>1%	2%	1%
General Pro Rata	6%	1%	11%	6%
Liberal	7%	>1%	3%	3%
Pro Rata	7%	3%	9%	6%

Source: Authors' elaboration based on VAT analysis

7.1.4 VAT treatment of asset management services

According to the CJEU jurisprudence, asset management services are to be considered exempt when supplied to a collective investment vehicle. However, the definition of 'collective' investment vehicles is not uniform across the Member States. For instance, in certain countries, the supply of asset management services to an insurance company, which itself manages own reserves 'on behalf' of policyholders, is considered individual portfolio management and thus taxable; in others, the collective dimension of the

policy portfolio is deemed sufficient for the exemption to apply. This varied interpretation was investigated in the fieldwork countries, as discussed in Section 3.1.2 above.

VAT incurred on asset management services supplied to financial institutions or insurance companies is, to a large extent, non-deductible due to their limited input VAT recovery. As a result, outsourcing such services to third-party providers generally entails an additional irrecoverable VAT cost compared to performing them in-house. Where the VAT exemption for asset management services is interpreted more broadly, these services can be supplied without VAT. This removes the tax-induced cost disadvantage of outsourcing and makes external provision more comparable to in-house production from a VAT perspective. In such cases, financial institutions are more likely to outsource asset management activities, as decisions can be driven by operational efficiency rather than tax considerations. Conversely, in jurisdictions where the exemption is interpreted more narrowly and asset management services are subject to VAT, outsourcing remains relatively more costly due to irrecoverable input VAT. This creates an incentive to internalise these functions within the firm or group. This can be tested looking at the share of supplies from asset management services (NACE 66) to customers in the other financial industries (NACE 64 and 65) across fieldwork countries.

The quantitative analysis shows mixed results, depending on whether one focuses on insurance companies or banks, though the limited number of observations means the analysis cannot be deemed statistically significant. For insurance companies, the VAT treatment positively influences the tendency to use external asset managers, which is indeed higher in countries in which those services are considered exempt. This is in line with the legal analysis, which shows the treatment of asset management services to insurance companies to be the area of greater uncertainty and divergence. It also confirms the fact that a broader application of the exemption to inputs lead to more outsourcing when the supplier, i.e. an insurance company in this case, makes only or exclusively exempt supplies. In contrast, the analysis shows that banks do not outsource more asset management in countries with a broader interpretation of the exemption. Though the reason could not be determined from the data, a potential explanation is that the banking sector (in comparison with insurance) is more likely to offer asset management services as part of their portfolio, and hence to handle such tasks in-house regardless of their VAT treatment.

Table 34. Outsourcing of asset management services in countries with different VAT treatment

	Asset management services (CPA 66) in total intermediate use		
Local treatment of asset management services	**Banking**	**Insurance**	**Other financial services**
Exempt	13%	52%	45%
Exempt under special circumstances	16%	34%	12%
Not exempt	21%	32%	34%

Source: Authors' elaboration based on VAT analysis, Supply and Use Tables

7.2 Analysis of compliance costs

7.2.1 Administrative costs for private stakeholders

This section presents the detailed findings on the administrative costs faced by private stakeholders. As mentioned above, the key findings are largely in line with the previous study, namely that **administrative costs – both from VAT and sectoral taxes - are generally not considered a major concern for providers of financial services**.[326] A similar picture emerged for wider tax compliance and compliance with other sectoral taxes.

In terms of numbers, the estimated costs add up to a meaningful amount, namely **about EUR 1.3 billion per year for VAT compliance and close to EUR 900 million for compliance with sectoral taxes**.

[326] Among compliance costs, administrative burdens are the primarily relevant category for the analysis conducted here. Throughout this section, the terms compliance costs and administrative burdens are used interchangeably.

However, when put in perspective with the size of companies in the sector, as well as turnover and average staff costs, the estimated administrative burdens for complying with VAT and sectoral taxes appear marginal. Moreover, according to stakeholders, these costs pale in comparison to the costs of other regulatory obligations that fall on financial institutions. While this reflects the experience of the large financial institutions and insurance groups that make up the majority of the sector, it cannot be excluded that compliance costs represent a more substantial burden for smaller financial service providers, for whom the fixed costs of compliance may be proportionally higher relative to their size and resources.

As for the **methodology** used to assess administrative costs, the stakeholders' consultation was designed to cover both quantitative and qualitative insights into administrative costs, with the main quantitative focus lying on costs generated from overall tax, VAT, and other sectoral taxes compliance. This was complemented with qualitative assessments on these burdens for companies that could not provide exact data. A qualitative judgement was asked from stakeholders also on how burdensome individual provisions of the VAT exemption are – i.e. proportional deduction, option-to-tax, and VAT groups –, in order to cross-check and potentially update findings in this regard from the previous study. Additionally, a comparison in compliance terms between the VAT exemption and standard VAT treatment was requested from private sector actors. Finally, the analysis was considered in the light of existing literature on tax compliance costs for private operators. Box 7 below provides more detail on methodological aspects.

Box 7. Administrative costs – methodological considerations

This study analyses administrative costs for financial institutions related to VAT and sectoral taxes. In terms of the types of regulatory costs, the VAT Directive generates administrative costs and burdens for taxpayers. The analysis is based on the consultation data deemed sufficiently detailed and robust, provided by 31 financial institutions, including banks, insurance companies, asset managers, and other providers of financial services. Quantitative data could be obtained from businesses in ten Member States, namely: Germany, Greece, France, Italy, Ireland, Lithuania, Luxembourg, Malta, the Netherlands, and Sweden. These 10 Member States represent over 60% of the entire financial sector business population, while also covering different approaches to the most important VAT provisions (e.g. option to tax – yes or no; VAT Group – available or not available and mandatory or voluntary, etc.). In addition, administrative costs were discussed qualitatively during interviews in all 12 fieldwork countries, and were covered in the survey of business federations, representing the views of stakeholders from non-fieldwork countries.

During the data analysis, it emerged that there is a notable break in terms of the level of administrative costs, which was identified roughly around a threshold of EUR 2 billion in annual turnover. Considering data from the Orbis database for 2023, entities with a turnover over EUR 2 billion, though economically very important, make up a small share (roughly 2%) of the number of financial companies. The data indicates that such large financial institutions have markedly higher administrative costs than smaller financial services providers. Interestingly, the data also suggests that even very small companies in the sector have a quasi-fixed level of administrative costs. This kind of classification and insight is roughly in line with the approach taken by the European Banking Authority (EBA) in its regulatory cost assessment, where the banking population was split into SNCI (small and non-complex credit institutions), medium, and large banks.[327] In the EBA study, the sample was split based on the size of assets under control, but this approach is tailored to banks, while turnover represents a more horizontal size parameter. According to the EBA study, large entities are also a minority (9% of the population) and show notably higher administrative costs, while SNCI and medium banks have costs per institution that are relatively similar.

In line with these findings from the collected data, administrative costs were estimated at two different levels, one for 'smaller entities', below the threshold, and one for 'larger entities', above the threshold. This bottom-up data-driven approach does not hold any relation to sectoral classifications or any SME classification, whose use to segment financial institutions would not be appropriate given the typical company characteristics.

The population of financial institutions was determined using data from the sectoral analysis, including 4,788 credit institutions, 3,679 insurance companies, and 6,910 investment fund management companies, for a total of 15,377 institutions. Based on Orbis database data (2023), this population was further segmented into 374 larger institutions with a turnover of more than EUR 2 billion and 15,003 smaller institutions. For sectoral tax compliance, the data was adjusted in two ways, in line with the findings from the analysis of sectoral taxes and the targeted consultation. Firstly, the business population was adjusted by excluding Estonian businesses from it, as no sectoral taxes were identified for the country. Secondly, the targeted consultation and sectoral tax analysis showed that asset managers are

[327] EBA (2021), Study on the cost of compliance with supervisory reporting requirements, Report EBA/Rep/2021/15.

generally less affected by sectoral taxes, compared to banks and insurers, and have, therefore, lower administrative costs. Consequently, the administrative costs for asset managers were estimated at a lower level, as specified in the analysis below.

The assessment of administrative costs covered both internal personnel costs, based on full-time equivalents (FTEs) dedicated to tax compliance, and external costs, such as advisory services, IT adaptations, and compliance software. While extensive data was gathered on personnel costs, external cost estimates proved more difficult to obtain. Many financial institutions rely on outsourced service providers for IT and tax compliance, making it challenging to attribute a specific portion of outsourcing costs to VAT-related tasks. Additionally, information on dedicated staff times and money spent on external service providers is considered confidential by operators, and some businesses were unable to share detailed figures. Despite these challenges, the data sample provided a robust basis for estimating the administrative burdens across different financial institutions in terms of both internal and external costs.

For monetisation, cost estimates were calculated using data from the Eurostat Earnings Survey, broken down by Member State and profession type, using 'professionals' as the typical personnel performing tax compliance functions. This used the most recent available vintage, from 2022, and costs include a 25% overhead, in line with the Standard Cost Model methodology. This ensures that the estimates reflect not only direct wages, but also additional employer expenses related to these roles. When aggregating for the EU-level, the average earnings per employee for the EU from the Eurostat Earnings Survey was EUR 64,346 for 2022.

As for the BAU (Business As Usual) factor, the share is set at 0, meaning that the assessment takes as given unrelated administrative costs, and that the estimates made reflect the *additional* costs of complying with VAT and sectoral taxes

➢ *VAT administrative costs*

Complying with the VAT exemption for financial services imposes **administrative burdens** on businesses in this sector, which often starts with the fundamental challenge of determining whether a specific service is exempt or taxed. Administrative burdens arise from various VAT-related obligations, such as maintaining accurate VAT records, submitting VAT returns, handling partial VAT deductions, and responding to questions or audits from tax authorities. While the previous study primarily examined the burdensome nature of specific provisions, this study takes a broader perspective, focusing on the overall administrative costs associated with VAT compliance.

Within financial groups, a central VAT function is normally responsible for a range of compliance activities to ensure proper VAT treatment across business operations. These tasks typically include submitting VAT returns, managing VAT payments and reimbursements, filing VAT refund applications, and maintaining VAT sales lists. Additionally, VAT teams provide guidance on invoicing and cost allocation, monitor and apply pro-rata VAT deductions, and oversee complex structures such as VAT groups. In some cases, they are also responsible for monitoring the use of the option to tax and managing interactions with tax authorities during audits. By contrast, tasks such as VAT ledger annotations and invoicing are often integrated into finance and accounting functions, alongside general bookkeeping and accounting operations.

The collected data indicates that the required staff times for VAT compliance can vary significantly between companies, ranging from as little as one-third of an FTE to as much as 10-15 FTEs. The variation in staffing requirements across businesses can be attributed to several factors: (i) company size, as larger firms handle more transactions and data; (ii) corporate structure, including whether a company is part of a VAT group; or (iii) the level of automation, as firms with tailored IT systems that integrate VAT compliance processes tend to require fewer manual interventions.

The data shows a **clear distinction between smaller and larger entities** when it comes to required personnel time for complying with VAT. For **financial institutions with an annual turnover below EUR 2 billion** (the vast majority, i.e. 98% of relevant companies), VAT compliance requires between 0.1 and 2 FTEs, with a **median of 1 FTE**. In contrast, **large entities** with turnovers exceeding EUR 2 billion show greater variability, requiring between 0.45 and 15 FTEs, with a **median of 2.75 FTEs**. External administrative costs also increase with business size (though data on these expenditures is less comprehensive). Regarding external VAT compliance services, median estimates indicate that smaller entities spend approximately EUR 15,000, while larger firms typically spend around EUR 50,000, with some reporting expenditures exceeding EUR 1 million per year, depending on their level of outsourcing.

When monetised using Eurostat salary statistics, total VAT administrative costs per company vary significantly. For financial institutions with an annual turnover below EUR 2 billion, costs range from EUR 5,000 to just over EUR 100,000 per year. For larger entities (turnover exceeding EUR 2 billion), administrative costs range from EUR 50,000 to nearly EUR 2 million annually.[328] Relative to key financial indicators, VAT administrative costs represent approximately 0.01% of turnover and 0.04% of staff costs, with noticeable differences based on company size:

- **Smaller entities**: VAT administrative costs account for 0.04% of turnover and 0.20% of staff costs.
- **Larger entities**: VAT administrative costs account for less than 0.01% of turnover and 0.03% of staff costs.

Although these figures remain marginal in absolute terms, they indicate that VAT administrative costs weigh proportionally more on smaller financial institutions.

At the aggregate EU level, using estimated FTE figures combined with external administrative costs, **total VAT administrative costs for the financial sector are estimated at approximately EUR 1.3 billion annually**.[329] This represents roughly 1.9% of the VAT liability of the financial sector (see Chapter 5 or details on VAT liability). The calculation of VAT administrative costs is based on a total population of 15,377 companies, of which 374 are estimated to be large entities and the remaining 15,003 small entities. Table 35 illustrates how the estimated median FTE and external cost per company size are extrapolated to the EU-level.

Table 35. VAT administrative costs

	Personnel time (median)	Personnel cost (EU median – EUR)	External costs (median – EUR)	Annual cost per company (EUR)	Company population	Aggregate admin costs (million EUR)
Smaller entities (< EUR 2 billion turnover)	1 FTE	64,000	15,000	80,000	15,003	1,200
Larger entities (>EUR 2 billion turnover)	3 FTEs	193,000	50,000	240,000	374	90
					Total	**1,300**

Source: Authors' elaboration based on sectoral analysis, targeted consultation, Orbis database, and Eurostat.

Although no literature exists specifically on the VAT compliance burdens for financial institutions, these results are compatible with previous estimates on administrative burdens generated by VAT compliance. For example, in 2009, the European Commission estimated the administrative burdens generated by the VAT Directive[330]. Focusing on the most complex IOs, responsible for more than 80% of total costs, yearly administrative burdens for a large company were estimated at EUR 35,000.[331] Considering that even smaller financial institutions are typically larger and more complex than most of large companies, and the relatively high complexity handling of the exemption – as discussed below – the order of magnitude of the cost estimates is largely consistent. A more recent study estimated total tax administrative costs – of which VAT was identified as a major part – to account for roughly 1.9% of a company's turnover, on average.[332] Similar

[328] Eurostat Earning Survey, by Member States and type of professions.

[329] Using Eurostat Earning data for the EU.

[330] Cf. Capgemini (2009), EU Project on Baseline Measurement and Reduction of Administrative Costs, Final Report, Measurement data and analysis as specified in the specific contract 5&6 on Modules 3&4.

[331] Estimates have been recalculated using 2022 salaries.

[332] This study, importantly, focuses particularly on SMEs and assumes a 'normally efficient enterprise' with an annual turnover of about EUR 2 million, which is significantly smaller than companies generally found in the financial sector.

results were found in a 2014 study, where total tax compliance was estimated to amount for roughly 0.3% (medium-sized companies) to 2.5% (micro-sized companies) of turnover.[333] These results are however not comparable with the estimates provided above, given the significantly larger turnover of financial institutions and the different ways in which turnover is calculated.

Putting the VAT administrative costs in comparison to general regulatory compliance costs in the financial sector seems to confirm the findings of the targeted consultation that VAT compliance is only a fraction of the wider regulatory burdens in the sector. In a 2019 study, the European Commission provided estimates for total compliance costs in the financial sector.[334] Focusing only on ongoing administrative costs (leaving aside the significant one-off costs), they can be estimated to be over EUR 10 billion per year.[335] A study by the EBA from 2021 places the total compliance costs for the entire EEA banking population at over EUR 24 billion annually.[336] At the level of single institutions, the annual costs in the EBA study are estimated at roughly EUR 2.5 million for SNCIs and medium banks, while reaching over EUR 30 million for large entities. Comparing this to the VAT administrative costs per financial service provider shown in Table 35 above, **VAT compliance would account for somewhere between 1% and 5% of total regulatory compliance costs**, depending on the size of the company.

Box 8. Litigation costs

In the previous study, litigation costs arising from the VAT exemption for financial services were not identified as a major issue. During the targeted consultation for this study, **it was confirmed that VAT litigation is not a priority topic for either financial services providers or tax authorities**. While businesses report that the exemption regime – including the application of deduction rules – led to a higher number of objections during audits and occasional litigation, particularly in the banking and asset management sectors, tax authorities generally indicate that disputes related to the exemption were less frequent compared to other VAT provisions. The difference in perspective between operators and authorities likely reflects the varying vantage points of each group: for financial institutions, the exemption may be one of the most complex areas of VAT compliance, but for tax authorities with a broader, economy-wide focus, VAT disputes in financial services may be relatively less prominent compared to other industries. Indeed, for the authorities the presence of the exemption somewhat lowers the financial stakes. However, tax authorities from a few Member States stressed that litigation tends to be higher for the exemption, particularly in terms of complexity rather than frequency. Furthermore, financial and insurance service providers showed a low appetite for VAT litigation, preferring to resolve disputes through rulings or settlements rather than in court.

➢ *Key elements of VAT administrative costs*

While the primary focus of the analysis has been the overall administrative costs, the individual provisions contributing to administrative burdens for financial institutions were also discussed with stakeholders, in order to update the findings from the previous study.

Rules for Proportional Deduction

Determining deductible VAT remains a complex administrative process for financial service providers. The effort begins with allocating input costs between taxed, exempt, and mixed-use transactions, requiring adjustments to IT systems and tracking mechanisms. The actual calculation of deductible VAT involves the use of pro-rata methods, sectoral pro-rata, or special input tax recovery methods, depending on the Member State. In some jurisdictions, companies must also seek tax authority approval for specific deduction methods, adding further complexity.

Feedback from stakeholders confirmed that these requirements **continue to be one of the most resource-intensive aspects of VAT compliance**. The previous study found that staff effort dedicated to this process

[333] European Commission (2014), Study on tax compliance costs for SMEs.

[334] ICF & CEPS (2019), Study on the costs of compliance for the financial sector, report for DG FISMA, July 2019.

[335] The study was based on 11 Member States, including the UK. The presented estimate was recalculated for the current EU (excluding UK, extrapolating to EU27).

[336] EBA (2021), Study on the cost of compliance with supervisory reporting requirements, Report EBA/Rep/2021/15.

can vary significantly from 0.1 to 4 FTEs, with the median falling at 0.7 FTEs. The targeted consultation reiterated that the rules for proportional deduction are the most problematic provision when it comes to VAT compliance. While the responses show some geographical peculiarities, with stakeholders from some Member States reporting this provision as problematic at a much higher rate, no other provision was reported as bringing major problems by more operators than this one. Generally, businesses indicated that the situation around proportional VAT deduction has not changed notably since the previous study.

Option to tax. The application of option to tax remains a relevant but relatively limited source of administrative costs, as it is only available in certain Member States. Its main cost drivers relate to updating IT systems to process and report taxable transactions and training staff unfamiliar with VAT accounting. In Germany, companies must additionally verify the VAT status of their customers, creating further administrative effort. Some stakeholders reported that implementation can be a lengthy process, especially for smaller entities relying on the support of external IT services providers but once set up it appears to be largely unproblematic from a cost perspective. From the consultation, no clear picture emerged whether using the option to tax comes with higher administrative costs than a scenario where the exemption is fully applied, although some operators explained convincingly that using the option is more burdensome. The reasons are primarily the need to monitor that the option is applied correctly – including keeping track of the VAT status of customers in Germany – as well as the invoicing obligations that the option triggers.

VAT groups

VAT groups, where available, is primarily used to reduce the VAT burden on intra-group transactions, but also leads to lower administrative costs. The main cost elements include verifying the economic, financial, and organisational links between entities, submitting applications to tax authorities (where required), and consolidating VAT data across the group. Businesses reported during the previous study that forming a VAT group entails one-off costs ranging from tens to hundreds of thousands of euros, while the ongoing administrative burden varies depending on the extent of centralisation. Normal staff effort for compliance was estimated between 0.1 and 3 FTEs (median at 0.3 FTEs), with no noteworthy changes reported by any of the operators during the consultation.

Somewhat counterintuitively, companies operating in Member States where VAT grouping is mandatory report that this does not automatically translate into simpler compliance. Furthermore, some businesses indicated that mandatory grouping removes the certainty provided by formal application and approval procedures that exist under optional regimes. In optional systems, businesses actively apply for VAT group status and receive explicit approval, which provides a documented basis for their tax treatment and reduces the risk of disputes. Where grouping is mandatory, businesses are included automatically, but without this formal confirmation process, questions can arise regarding the precise scope of the group, the treatment of internal transactions, and whether all conditions are continuously satisfied. This can create ambiguities in tax treatment and the potential danger of inadvertent non-compliance leading to audit costs and fines.

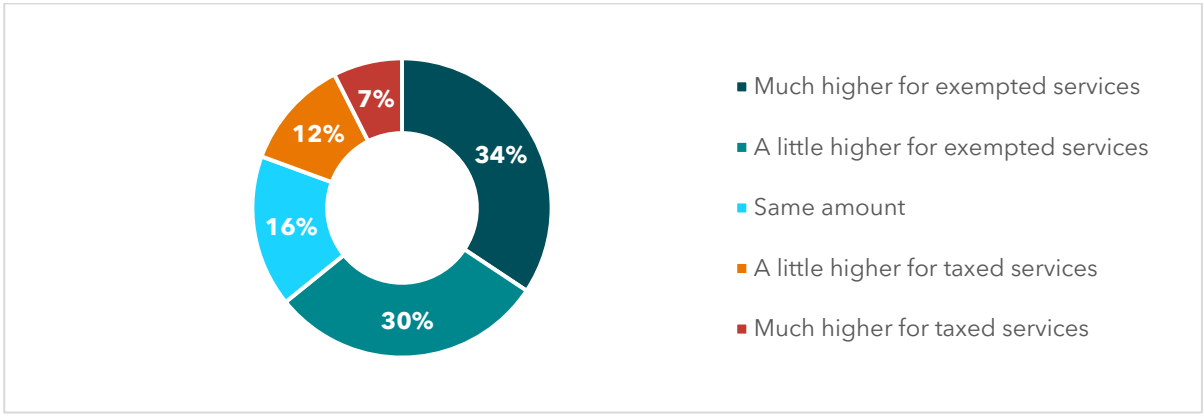
- ***Administrative costs – exemption versus standard treatment***

As part of the analysis of administrative costs stemming from the VAT exemption, a comparison was conducted to assess how administrative burdens differ between entities providing exempt services and those applying standard VAT treatment. The targeted consultation included a discussion with stakeholders on their views regarding the compliance challenges faced under each regime.

While some stakeholders – particularly those dealing exclusively with VAT-exempt services – were unable to compare the burdens, most respondents could share experiences. The responses were largely aligned, with both private operators and business federations broadly agreeing that **administration and compliance are more burdensome for providers of VAT-exempt services compared to standard VAT treatment**.

Figure 62 below illustrates the responses, showing that almost two-thirds of those providing input believe that administrative costs are either a little or much higher for providers of VAT-exempt services than for taxable services.

Figure 62. Administration and compliance costs under VAT exemption compared to standard treatment



Source: Authors' elaboration based on stakeholder consultation. Cf Volume 2 Annex 1.

The reasons cited for higher administrative costs for providers of VAT-exempt services largely relate to the aspects described in the section on VAT administrative costs above, namely the complexity of VAT treatment, difficulties in deducting input VAT, burdensome tax audits, and necessary adaptations to IT systems and internal processes. Stakeholders highlighted the following key aspects:

- Businesses must **distinguish between taxable and exempt services (and other supplies giving rise to a right to deduct)**, a process that is often not straightforward and requires significant resources. For credit institutions and insurance companies, determining which transactions qualify for the exemption can be particularly challenging. The lack of harmonisation across Member States further complicates cross-border transactions, leading to uncertainty and increased administrative costs. Several stakeholders mentioned additional burdens from determining the correct VAT treatment for intra-group or intra-company cross-border transactions.
- Unlike fully taxable businesses, VAT-exempt entities cannot fully reclaim input VAT, making **proportional deductions a major administrative challenge**. Pro-rata calculations must be conducted to determine deductible VAT amounts, requiring businesses to track and document mixed-use inputs meticulously. The granularity required in tracking input VAT for different business segments results in high manual effort, frequent adjustments, and audit risks. Tax authorities frequently challenge VAT deduction claims, leading to lengthy audits and potentially disputes.
- More generally, financial institutions bemoaned that **legal uncertainty** over the VAT exemption results in more burdensome administrative processes. Among others, operators often mention the lack of clarity over definitions (i.e. whether a service is in fact exempt or not) and proportional deduction methods.
- VAT-exempt entities need **tailored IT systems** to track exempt versus taxable transactions, calculate pro-rata deductions, and generate compliance reports. Enterprise resource planning (ERP) system modifications are costly and time-consuming, requiring companies to update and adapt their systems to changing VAT interpretations. Automating VAT compliance for exempt transactions is far more complex than for standard VAT treatment, often requiring manual adjustments.

While the majority of stakeholders agreed that VAT exemption increases compliance burdens, a minority noted that **exempt supplies benefit from certain simplifications**, particularly regarding invoicing and reporting requirements. Across the EU, financial and insurance transactions are generally relieved from the obligation to issue invoices, in accordance with Article 220(2) of the VAT Directive. In some Member States, VAT-exempt services are excluded from applying digital reporting and e-invoicing requirements and from reporting intra-EU cross-border transactions. This provides significant administrative savings for financial institutions, given the sheer number of daily transactions they process. Large banks, for example, conduct millions of output transactions annually, many of which would otherwise require invoicing in a fully taxable

system. Similarly, insurance companies issuing policies and premium requests benefit from this simplification, reducing the volume of invoicing and associated administrative effort.

The estimates are based on a bottom-up approach combining targeted consultation data and expert assumptions on transaction volumes, the share of B2B transactions (i.e. those requiring invoicing), and average per-invoice costs using third-party e-invoicing providers.[337] Representative firm sizes were used across subsectors (banks, insurers, and asset managers), and results were scaled using estimates of the number of firms in each segment. In total, **estimates from the previous study suggested that the removal of invoicing requirements results in savings of nearly EUR 150 million annually**.[338]

Table 36. Savings from Invoicing: Annual Saving per Company

	Transactions per year	B2B invoices	Cost per invoice (EUR/inv)	Savings per company (EUR)	# Companies	Total savings (EUR million)
Bank	2,000,000	700,000	0.034	24,100	4,788	115
Insurance	350,000	70,000	0.034	2,400	3,679	10
Asset Manager	145,000	50,000	0.034	1,700	6,910	15
Total						**140**

Source: Authors' elaboration based on sectoral analysis, targeted consultation, and ViDA report

In principle, Article 272(1)(c) of the VAT Directive allows Member States to relieve operators from certain obligations if they only supply exempt services. However, these are generally not widely applied to financial and insurance service providers, as most institutions have at least some taxable transactions, making full exemption from VAT reporting impractical. In a few cases, tax authorities have adopted a pragmatic approach, such as Luxembourg's rule allowing businesses that exclusively provide exempt services to forego VAT return filings. In practice, this primarily benefits insurance intermediaries rather than banks or insurers, as most financial institutions still supply at least a small portion of taxable services. Another simplification, reported by some stakeholders, is the relatively low scrutiny of VAT ledgers and invoices during tax audits, since VAT deduction claims are minimal in these sectors.

A more structured simplification exists in Italy through the so-called Article 36-bis regime, which allows financial institutions and insurance companies to be exempted from maintaining output VAT ledgers in exchange for fully renouncing any input VAT deduction. This regime has been widely adopted by Italian banks and insurance companies, either for all their activities or for specific sectors within their operations. While it is difficult to quantify the precise savings from this regime, estimates from the previous study[339], based on forgone deductions, suggest that compliance cost reductions could be substantial, with large insurance companies potentially saving EUR 1 to 2 million per year and the banking sector as a whole benefiting from estimated savings of EUR 13 to 15 million annually. These findings highlight that, while targeted simplifications in some Member States help mitigate the impact of administrative costs, they remain relatively high for businesses subject to the VAT exemption regime compared to the VAT standard treatment, according to economic operators.

[337] Cf. Economisti Associati, Oxford Research, Case, Wavestone, Hedeos, Mazars, Desmeytere Services and Universita di Urbino (2022), Report to the European Commission, VAT in the Digital Age, Final Report, Volume 1, Digital Reporting Requirements.

[338] Based on previous study, adjusted for increase in salaries.

[339] Rohmer B., Luchetta, G., Poli. F., Poniatowski. G. et al, (2021) 'Review of the VAT rules for financial services, in light of the existing regulatory and other indirect taxation rules', submitted to the European Commission. in January 2021. Specific Contract TAXUD/2019/DE/313 (unpublished).

➢ *Other sectoral taxes*

In addition to assessing VAT administrative costs, the study also examined the broader administrative burden that taxation places on financial institutions. The purpose of this analysis is twofold: first, to provide further context for the burden stemming from sectoral taxes and VAT compliance within the overall tax compliance framework; and second, to better understand the cumulative administrative effort required to comply with various tax obligations. Furthermore, sectoral taxes, imposed at the national level, are a key consideration in this analysis, not only due to their relationship with the VAT exemption but also because of their fragmented nature across the EU. These taxes vary widely across Member States and often contribute to administrative complexity and compliance costs for financial service providers.

To evaluate these costs, the targeted consultation included questions on overall tax compliance costs, as well as those specifically associated with sectoral taxes. The assessment of those burdens during the interviews was done together with that of VAT compliance, asking for both quantitative and qualitative estimates of the respective costs. The findings, presented in detail below, confirm that **tax compliance represents a notable administrative burden for financial institutions in absolute terms, but remain relatively minor in comparison** to both the size of the companies and other regulatory burdens.

Assessment of costs

As discussed in detail in Section 6 the financial services sector is subject to a wide range of sectoral taxes, which many Member States levy on the sector, sometimes as a replacement for VAT (particularly IPTs). Consequently, the analysis of administrative costs also covers the administrative burdens that come with the specified sectoral taxes, such as IPTs, bank levies.

Similarly to VAT, administrative costs from other sectoral taxes show a clear and predictable relationship to the size of a business operation. Interestingly, the results from the targeted consultation indicate that **administrative costs from other sectoral taxes are very similar to those stemming from VAT**, but it is important to remember that other sectoral taxes cover a range of 92 tax measures. For smaller banks and insurances entities (with a turnover below EUR 2 billion), compliance with other sectoral taxes requires between 0.5 and 8 FTEs, with a median of 1 FTE. Larger entities, in turn, allocate between 0.5 and 20 FTEs, with a median of 3 FTEs to sectoral tax compliance. For asset management companies, the median FTE is assumed at 0.5 FTE and 1.5 FTEs, respectively, based on feedback during the targeted consultation. This variation reflects the fact that not all financial institutions are subject to the same sectoral taxes, with some firms facing significantly higher compliance requirements than others. For illustration, certain entities placed the burdens at 0, in the absence of any such sectoral taxes, while a few operators placed them at 18 or even 20 FTEs. Data for external costs related to the sectoral taxes was harder to come by, but the median for the entire sample falls at roughly EUR 12,000, although it can be close to EUR 1 million annually for certain companies – particularly those with many cross-border dealings.

The **personnel costs** to handle compliance with other sectoral taxes for small and large financial institutions and insurance companies are similar in aggregate to those required for VAT compliance. This is in line with the qualitative assessment from the targeted consultation. However, while the administrative costs for a typically efficient company are similar, there are still significant differences between VAT administrative costs and those for sectoral taxes. First, administrative costs for sectoral taxes often encompass several taxes, meaning that compliance with each individual sectoral tax is simpler than VAT. Considering a total of 92 tax measures across the EU, the tax burden per tax occurrence is approximately less than one-third of that of VAT.[340] Secondly, the number of sectoral taxes varies across countries, and, in countries where operators would be subject to only one such tax, compliance efforts are correspondingly lower. Finally, the business model and organisational structure of an entity have a significant impact on the administrative burden of sectoral taxes. For example, the headquarter of a large insurance group may centralise and therefore carry the burden associated with IPTs across multiple jurisdictions, covering subsidiaries

[340] Considering 92 tax measures across the EU, each Member State has slightly over 3 measures on average, meaning that a company would face roughly 3 sectoral taxes.

operating throughout the EU, with significantly higher costs compared to smaller domestic companies that only deal with the local IPT.

Monetising the costs, total administrative costs for other sectoral taxes per company **vary significantly**[341]. The results from the compliance cost analysis for other sectoral taxes is summarised in Table 37 below[342]. For a smaller bank or insurance company, annual administrative costs are estimated at EUR 70,000; for larger ones, they reach more than EUR 200,000. Lower costs are estimated for asset managers, which face fewer sectoral taxes, namely at EUR 35,000 and 105,000 for smaller and larger entities. Relative to key financial indicators, administrative costs for sectoral taxes represent on median approximately 0.003% of turnover and 0.04% of total staff costs.

These estimates represent average annual costs for all sectoral taxes in a country; considering that, on average, each financial institution deals with three sectoral taxes, cost per tax can be estimated at EUR 10,000-25,000 for smaller financial institutions, and at EUR 35,000-70,000 for larger financial institutions. One single sectoral tax thus generates a fraction of the administrative costs attributed to VAT: between 10 and 30% for smaller financial institutions, and between 15 and 30% for larger financial institutions.

At the aggregate EU level, using estimated FTE figures combined with external administrative costs, total administrative costs for sectoral taxes in the financial sector are **estimated at close to EUR 900 million annually**. Rescaling per the average number of sectoral taxes per country, aggregate sectoral tax administrative costs are about 25% of the VAT administrative costs. Compared to tax revenue from sectoral taxes, the administrative costs for sectoral taxes account for about 1.1% of tax revenue from said taxes.[343]

Table 37. Administrative costs from other sectoral taxes

	Personnel time (median)	Personnel cost (EU median - EUR)	External costs (median - EUR)	Annual cost per company (EUR)	Company population	Aggregate admin costs (million EUR)
Small banks & insurances	1 FTE	64,000	5,000	70,000	8,212	570
Large banks & insurances	3 FTEs	193,000	20,000	215,000	205	45
Small asset managers	0.5 FTE	32,000	3,000	35,000	6,725	235
Large asset managers	1.5 FTEs	97,000	10,000	105,000	168	20
					Total	**870**

Source: Authors' elaboration based on sectoral analysis, targeted consultation, and Eurostat

In discussions, stakeholders provided quite different views on the burdens that other sectoral taxes generate and how they compare to those caused by the VAT exemption. As described, this can be down to national specificities but also related to particular sectoral taxes and how they align with the business models of the respective institutions. While some sectoral taxes are relatively straightforward to administer, others require additional monitoring, reporting, and record-keeping, adding to administrative costs. Two specific examples mentioned during the consultation were the complex compliance with an FTT, on the one side, and the relatively simpler administration of IPTs. That said, IPT compliance is not without

[341] For financial institutions with an annual turnover below EUR 2 billion, costs stay below EUR 500,000 per year, in most cases even below EUR 100,000. For operators with a turnover exceeding EUR 2 billion, compliance costs might reach close to EUR 2 million annually.

[342] Compared to VAT, the population is smaller because sectoral taxes are not in place in all countries and for all three sectors in all countries.

[343] Importantly, tax revenue on sectoral taxes covers only 80 out of 92 identified tax measures, as no data was available for the remaining 14 measures.

complexity in all cases, as some stakeholders flagged concerns regarding the risk of double taxation or non-taxation of insurance premiums in group insurance contracts, where the policyholder and the insured persons are located in different Member States, owing to divergent national definitions of the term 'policyholder'. Importantly, particularly among banks, a recurring point made is that the sectoral taxes are relatively straightforward to handle, when compared to other administrative burdens resulting from the sectoral framework.

On windfall taxes, respondents generally found the ongoing administrative costs manageable once implemented, but noted that one-off implementation at the time of introduction can pose a more considerable burden. A recurring concern was the unpredictability associated with taxes initially introduced as temporary measures subsequently being extended or made permanent, which adds uncertainty to compliance planning. Bank levies, by contrast, were not flagged by respondents as generating significant administrative costs, with stakeholder feedback focusing instead on questions of legal certainty and economic design.

7.2.2 Enforcement costs for tax authorities

As part of the assessment of compliance costs, the study also examined the administrative and enforcement costs that the VAT exemption for financial services places on tax authorities. In the previous study, enforcement costs were not identified as a significant burden, and this was largely confirmed during the current interview programme. For this reason, and considering that tax authorities were seldom able to provide cost data, the analysis consists of a detailed qualitative assessment.[344]

The analysis focuses on four key aspects: (i) a comparison of administrative enforcement costs linked to the exemption and to other areas of VAT compliance in the financial services sector, (ii) the costs associated with enforcing the exemption across different types of financial service providers, (iii) the costs related to specific provisions in scope of the study, and (iv) the prevalence of VAT non-compliance and fraud in the financial services sector. The findings can be summarised as follows:

- **Comparison to other areas of VAT compliance**. Member State officials reaffirmed that the administration and enforcement of the VAT exemption for financial services do not represent a major burden for tax authorities, which is in line with the findings from the previous study. A majority of tax authorities indicated that administration and enforcement costs for these provisions are similar to or lower than for other areas of VAT compliance. Only a few Member States reported higher enforcement costs, mainly due to the complexity of audits for financial service providers rather than the volume of cases. This is in line with what Member States reported on litigation costs, namely that the VAT exemption is relatively unproblematic, but its complexity and the size of entities that is being dealt with can create significant costs in select cases.
- **Enforcing the VAT exemption across different financial service providers**. When assessing enforcement costs across different types of financial service providers, banks were identified as the most burdensome to administer, due to their sheer complexity. However, even for banks, more than two-thirds of tax authorities reported that enforcement costs are not significant. Insurance companies were seen as even easier to administer, with very few tax authorities reporting notable enforcement burdens. As for other financial service providers, such as asset managers, administration and enforcement costs also remain negligible across all operators in the financial sector.
- **Costs of enforcing specific provisions**. the results not only confirm the findings from the previous study but also those from the analysis of administrative costs for private operators in the sense that the rules for proportional deduction are the most burdensome provision to enforce. With that said, only a handful of Member States reported significant costs, while the majority rated specific costs related to that provision as negligible or non-existent. VAT groups were considered even less costly

[344] All Member States were asked for their assessment of these costs as part of the written survey or during the in-depth interviews of the stakeholder' consultation, in which costs stemming from the exemption were addressed in more detail.

to enforce by Member States. Similarly, costs related to the option to tax and CSAs were reported to be minimal by those authorities who could provide an estimate[345].

- **VAT non-compliance and fraud in the financial sector** – the overwhelming majority of responses indicated that fraud and non-compliance in this area are negligible or not an issue at all. This was attributed by several Member States to the highly regulated nature of the financial sector, making intentional VAT fraud unlikely. One tax authority noted that fraud itself is not a major concern, but the rapid evolution of financial products creates legal uncertainty, making it difficult for tax administrations to keep pace with regulatory developments.

Overall, the results suggest the **administration and enforcement of the VAT exemption for financial services does not represent a significant cost burden for tax authorities**, and that **VAT fraud in the sector remains of limited concern**. The majority of tax authorities do not consider the VAT exemption to be more costly to administer than other areas of VAT compliance, and while certain provisions, such as proportional deduction, were acknowledged as more complex to enforce, these costs were rated as negligible by most respondents[346]. Similarly, VAT groups, the option to tax, and cost-sharing arrangements were found to generate little to no additional administrative effort for most tax authorities. The differences in enforcement burdens across different financial service providers were also relatively minor, with banks being slightly more complex to administer than insurance companies but still requiring minimal enforcement resources in most cases.

This is not to say that enforcement of the exemption comes without its challenges, which is particularly down to administering specific complexities and large-scale businesses, as was highlighted by a few authorities. Fraud and non-compliance were overwhelmingly considered to be non-issues, largely due to the highly regulated nature of the financial sector, which limits opportunities for deliberate VAT evasion. While a few authorities noted that legal uncertainty, particularly concerning rapidly evolving financial products, can occasionally lead to compliance challenges, these were seen as the exception rather than a widespread issue. Taken together, these findings confirm that, from the perspective of tax authorities, the VAT exemption for financial services does not impose a significant enforcement burden and remains a manageable area of VAT administration.

Tax authorities were also asked about the **enforcement costs generated by sectoral taxes**. The responses indicate that, for most Member States that responded, these costs are negligible, with the majority of respondents reporting negligible or no enforcement costs across all their sectoral taxes. More in detail, among 18 responding authorities, only 2 considered the enforcement costs of a sectoral tax to be significant. This reflects in part the fact that the taxpayer base for these taxes consists of professional, regulated financial institutions, which minimises compliance risks and the need for targeted enforcement action. Two exceptions to the general pattern of low enforcement costs were noted, with significant enforcement costs reported across multiple sectoral taxes in one case, and specifically for a windfall tax in another. The latter was attributed to personnel training, IT system adaptation, and the creation of new administrative processes. This is consistent with the broader finding that newly introduced taxes, particularly temporary measures such as windfall taxes, generate a disproportionate one-off enforcement burden at the time of introduction, even where ongoing costs remain modest. One respondent additionally flagged a specific cross-border enforcement challenge regarding taxes owed by foreign insurance companies operating in its territory.

7.3 Overall economic impacts on the taxation of financial services

This section assesses the combined economic impacts of the taxation framework in terms of competitiveness, the centralisation of input supplies, and the Single Market / international competitiveness

[345] Only a few Member States provided responses, as the option to tax is not available in all jurisdictions and CSAs have largely been phased out following the ECJ ruling (see Section 5.2.5).

[346] See Volume 2 – Annex 1.

of the EU financial sector. The analysis suggests that the fiscal treatment of the financial sector has the following broad consequences:

- The economic analysis indicates a negative correlation between the tax burden (including VAT and sectoral taxes) and profitability of the financial sector, and specifically for sectoral taxes alone.
- Both the economic literature and the analysis suggest that sectoral taxes treatment can have some impact on the financial sector, most prominently on the banking sector, where bank levies can impact lending rates and net margins, while sector-specific taxes like windfall taxes can distort business decisions.
- Because VAT on inputs is (mostly) irrecoverable, **the exemption increases the cost of purchasing input supplies**, both within a group ('groupsourcing') and from third parties (outsourcing); this distorts business models and company structures, with negative effects on the efficiency of value chains.
- As discussed in detail in Section 3.2 on third countries, the exemption for financial services in the EU has a broader scope and less means to reduce hidden VAT than other jurisdictions. As a consequence, **EU players bear a higher VAT burden in the form of irrecoverable VAT than their international competitors**[347].

7.3.1 Competitiveness

The analysis starts with the impact of the level of taxation[348] on the competitiveness of the financial services sector, measured by its profitability.[349] This first considers the impact of the total tax burden in scope of the study, i.e. the sum of sectoral taxes and VAT liabilities, and then of sectoral taxes and VAT separately, as well as certain components thereof (namely IPTs, bank levies, windfall taxes, hidden VAT). The quantitative analysis is repeated for each of those categories, jointly or separately, to make sure that all potential impacts are checked, verified and quantified. The analysis focuses, for the most part, on indirect taxes; while additional and special rates of corporate income taxes for the financial services sector are considered, it does not include corporate income taxes *per se*.

A 'coefficient factor', i.e. the extent to which tax revenues and profitability move in the same or opposite direction is estimated for each element; when possible, a 'regression coefficient', which measures how much a change in tax revenue affects profitability, is also presented. In most cases the results are not significant due to the relative dispersion of data points, suggesting that any relation between fiscal measures in scope of the study and the competitiveness of the financial industry is weak, and possibly subject to reverse causation mechanisms (i.e., higher taxes are introduced in countries in which the financial sector has higher profits). Also, the impact of corporate income taxation level, except for additional and special rates, is not covered. This means that, aside from a few cases, the hypothesis that differentiated taxation has no or negligible impacts on competitiveness cannot be discarded. Hence, the results do not represent conclusive findings; at the same time, they still suggest a direction of possible impacts, or the lack thereof, and its likely magnitude.

The joint effect of sectoral taxes and VAT on the financial sector is negatively correlated with its profitability; this means that, in countries with a higher tax burden, the sector's profits are on average lower. The value of the regression coefficient is 0.14, i.e., for each 1 pp increase in the revenue-to-output ratio, profitability decreases by 0.14 pp. Although **the coefficients and results are not statistically significant**, they are consistent with the intuitive hypothesis that relatively higher tax burdens

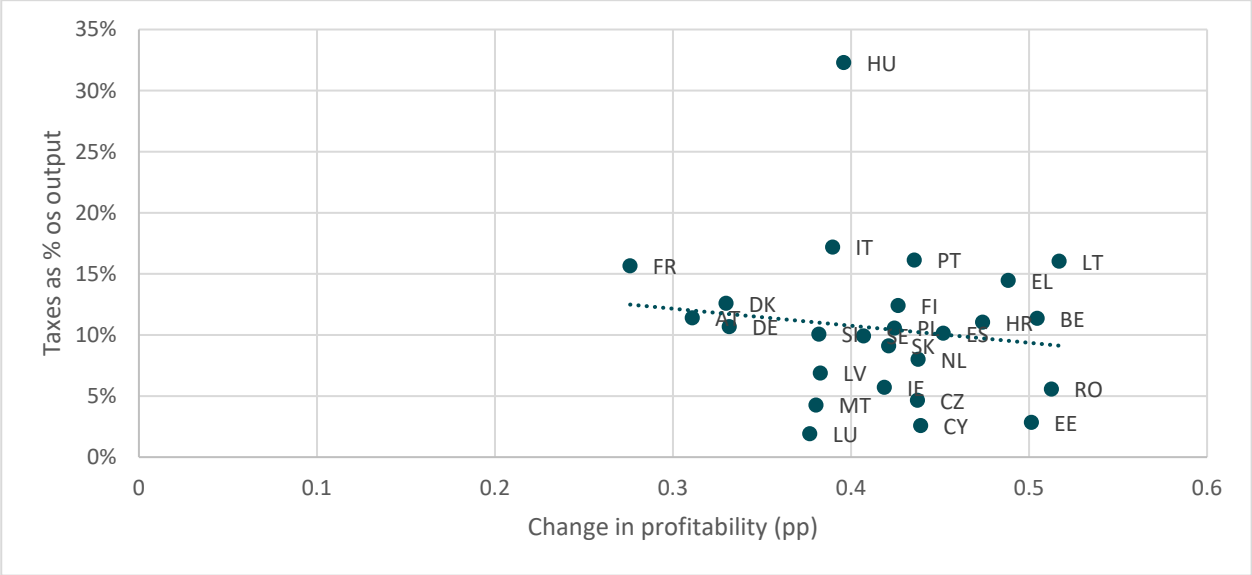
[347] Cf. Section 6.2.2. above on the estimates of VAT liabilities.

[348] As measured by the ratio between tax revenues from our own analysis and sector's supplies (from SUT).

[349] Profitability is measured by the gross operating surplus, as reported by Eurostat national accounts statistics. Other sectoral measures of profitability, e.g. return on assets, could not be used because they are not homogenously available for all types of financial institutions in scope of the analysis. The analysis also tested the use of gross value added as a proxy of competitiveness, but results are largely correlated with the analysis of the gross operating surplus and are therefore not presented.

are associated with lower profitability, as is also suggested by the economic literature (see discussion at the end of this section). The scatterplot between indirect tax revenues and sector's profitability is shown in Figure 63.

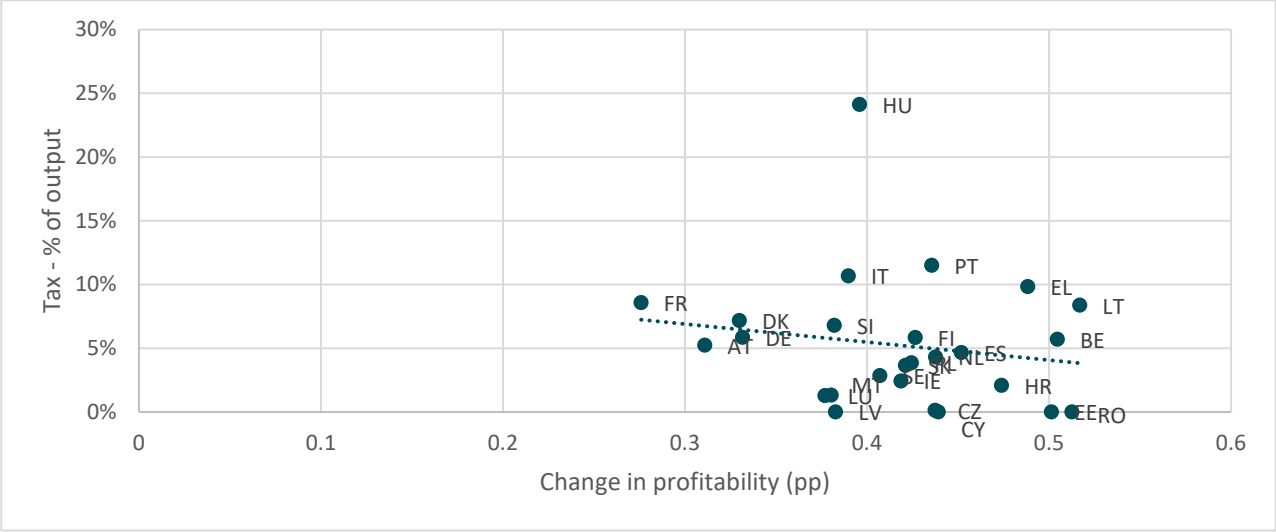
Figure 63. Correlation between taxes on the financial sector and profitability.



Source: Authors' elaboration based on VAT analysis and data from tax authorities, TEDB, Eurostat's SBS (2023 data)

Looking at **sectoral taxes specifically**, the analysis reveals a similar **negative correlation between the tax burden and the financial sector's profitability**. The estimated regression coefficient remains at 0.14, indicating that a 1 pp increase in sectoral taxes, relative to the sector's output, is associated with a 0.14 pp decrease in the financial sector's profitability. Again, this is in line with the intuitive findings that higher taxes are correlated with lower profitability. That said, it should be borne in mind that, as above, the results are not statistically significant. This relationship is visually represented in Figure 64 below. This is further confirmed by EBA research.[350]

Figure 64. Correlation between sectoral taxes on the financial sector and profitability



Source: Authors' elaboration on data from tax authorities, TEDB, Eurostat's SBS (2023 data)

[350] Cf Section 8.1.2

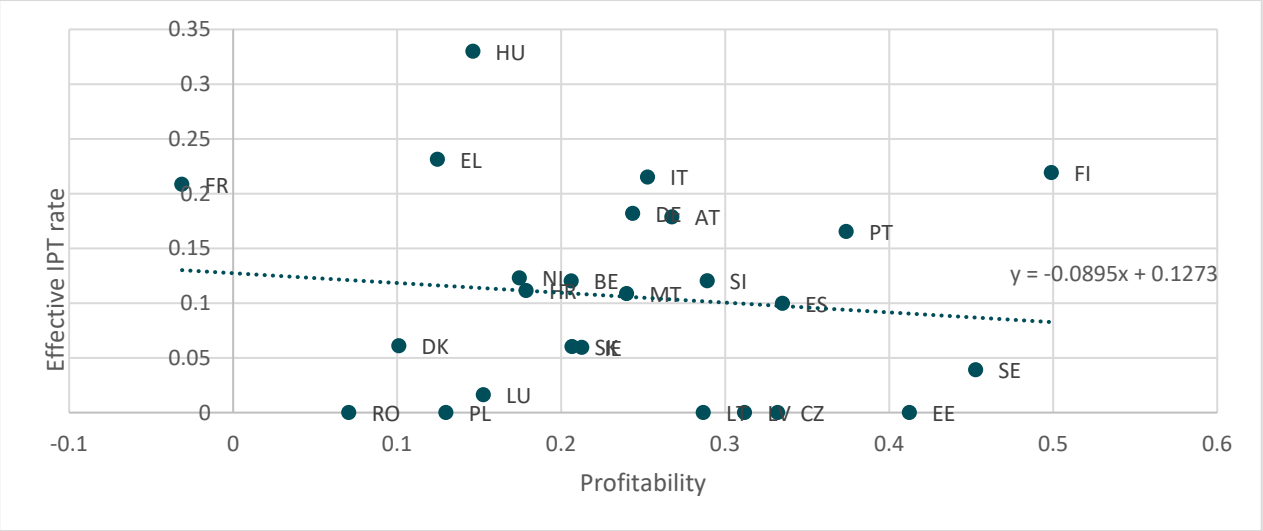
In addition to the tax burden, an analysis was also conducted to consider the **relationship between profitability in the financial sector and relative *numbers of sectoral tax measures***[351]. The hypothesis would be that dealing with a lot of different tax measures would be burdensome for financial institutions, regardless of the tax liability per se. This analysis compared the average profitability of the financial sector in countries with the highest reported number of distinct sectoral taxes against the average profitability of the sector across the EU as a whole. The results show that **average profitability in the countries with numerous sectoral taxes is almost identical to the overall EU average**. This finding suggests that the sheer number of distinct sectoral taxes, in isolation, does not exert a substantially different impact on average profitability compared to the broader EU trend, and hence that tax levels, rather than the number thereof, matters more.

When it comes to **specific forms of taxation**, the analysis starts from the **effects of IPTs**, which are the most prominent sectoral taxes both in terms of prevalence and revenue. The regression analysis, examining the impact of the **effective IPT rate** (measured as tax revenue to output ratio) on profitability, indicates a **very limited economic impact**. Specifically, for every 1 pp increase in the IPT revenue-to-output ratio, the profitability of the insurance sector is estimated to decrease by 0.09 pp. This means that the impact of IPT on profits is uncertain and, in any case, very small. However, as with other taxes discussed above, this coefficient is not statistically significant. Figure 65 below shows the scatterplot for this regression.

A potential explanation for the limited and statistically insignificant relationship between IPT rates and the sector's profitability is that a substantial portion of the IPT burden is effectively passed on to the consumer rather than being absorbed by the insurance companies. This would mitigate the direct impacts to the industry, and align with the economic literature (see Box 9 below), though it cannot be fully proved from the data.

Further complementary analysis explored whether the existence of an IPT in a Member State correlates with sectoral profitability, regardless of its rate. This descriptive comparison is depicted in the figure below. While not surprising, it shows that the **average profitability** of the insurance sector is approximately 7 pp **higher in countries without an IPT** compared to those with one. Conversely, the impact on profits of introducing IPTs is of seemingly limited magnitude. However, this finding is also not statistically significant. Furthermore, the robustness of this particular observation is tempered by the relatively small sample size of Member States without an IPT, which is comprised of just six countries, including some very small ones[352].

Figure 65. Correlation between IPT and profitability of insurance sector



Source: Authors' elaboration on data from tax authorities, TEDB, Eurostat's SBS (2023 data)

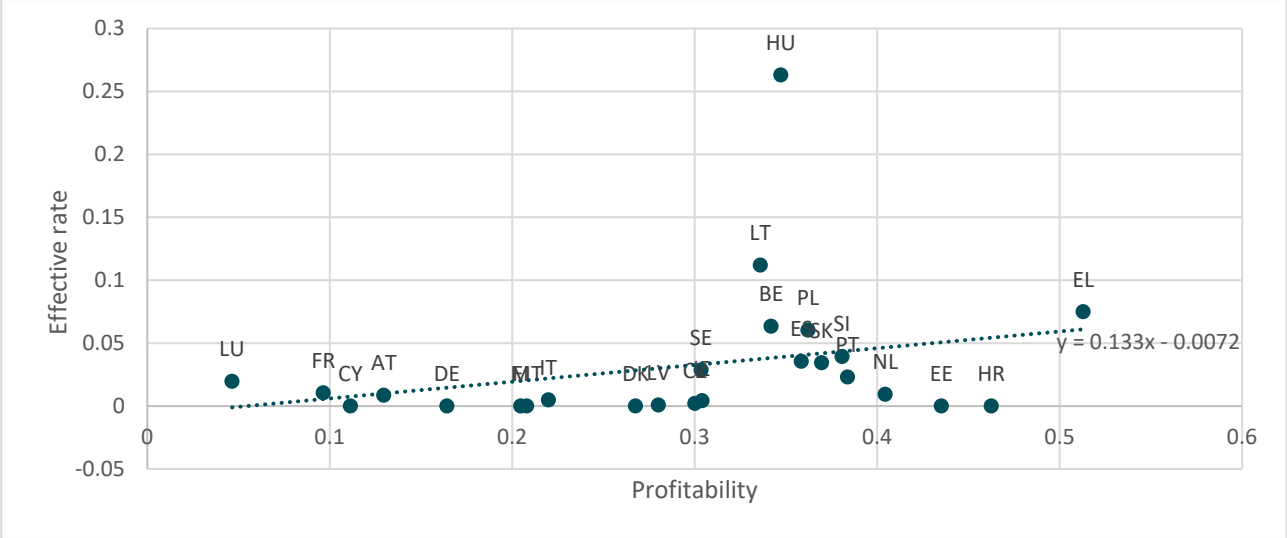
[351] A regression analysis using the number of sectoral taxes in each Member State was considered but proved unsuitable due to data limitations.

[352] Czechia, Estonia, Lithuania, Latvia, Poland, and Romania.

An analysis was also done on the impact of **bank-specific taxes**, namely bank levies, FTTs and windfall taxes on the profitability of the banking sector. Interestingly, the analysis suggests a **positive correlation** between the imposition of these taxes (again, measured as tax revenue to output ratio) and the banking sector's profitability. Specifically, a 1 pp increase in bank-specific taxes is associated with a 0. 13 pp increase in banking sector profitability. Furthermore, a descriptive analysis reveals that, on average, profitability is 5 pp higher in countries where a bank levy, FTT, and/or windfall tax is in place. Again, the correlations are not statistically significant.

Though potentially counterintuitive, the likely explanation is **reverse causality**, meaning that high profits drive the introduction of bank taxes rather than the other way around. In other words, such taxes are introduced in countries where they are likely to generate substantial tax revenue. For instance, windfall taxes are typically implemented to target high or above-average profits generated by the banking sector, often in periods of economic prosperity or specific market conditions. This explanation is less likely for bank levies, which were mostly introduced as a response to the global financial 2008 crisis. However, after many years, it is plausible that they remained or were increased in countries in which bank profits were higher and eliminated or reduced in countries with less competitive banks. Furthermore, as discussed in Box 9 below, the economic literature on the impact of bank levies does show some mixed results.

Figure 66. Correlation between bank-specific taxes and profitability of banking sector



Source: Authors' elaboration on data from tax authorities, TEDB, Eurostat's SBS (2023 data)

Finally, as for the impact of VAT, **the analysis does not show a clear impact in any direction. The VAT total tax liability** (VTTL, see discussion in Chapter 5) **is positively correlated (albeit weakly) with profitability**, meaning that countries with higher VAT liability also show higher profitability of the financial sector. This could mean reverse causation – VAT rules are stricter when financial institutions are more profitable – but this is not in line with the qualitative findings from consultation and desk research. Rather, drivers other than VAT liability are likelier to explain the profitability of the financial sector[353].

Focusing on hidden VAT only, it is uncorrelated from the sector's profitability, with the correlation coefficient very close to 0 (-0.2%). This means that the two variables have very little influence on each other. For insurance companies only, higher hidden VAT is correlated with lower profitability (-30% correlation coefficient), but the results are not statistically significant.

[353] The same trend (though not statistically significant) held for both the banking and asset management subsectors; for insurance VTTL is negatively correlated with the profitability of the insurance industry.

Box 9. Impact of sectoral taxes on the financial sector

Among economists, there exists at least two schools of thought when it comes to the impact of taxation on macroeconomic aspects, such as economic growth. A principal distinction can be drawn between the neoclassical[354] and the endogenous[355] growth models.

Endogenous growth models emphasise that taxes can affect long-run growth depending on how tax revenues are used. Taxes on capital and income can negatively impact growth by reducing incentives for investment, as indicated by Bin Xu[356]. However, these negative effects may be mitigated if the tax revenue is spent on productive investments, such as public infrastructure or human capital. Studies like Se-Jik Kim[357] also demonstrate that differences in tax systems across countries can explain significant variations in growth rates. As a consequence, the impact of financial sectoral taxes is highly dependent on the specific use of the revenue and the broader economic context, with indirect benefits possible if taxes are used strategically.

In contrast, **neoclassical growth models**, as seen in Cooley and Hansen[358], argue that taxes do not affect long-term growth rates. These models focus on exogenous factors like technological progress and population growth, with taxes seen as short-term distortions that do not alter the economy's steady-state growth trajectory. Blinder and Solow suggest that while taxes may temporarily distort economic behaviour, they do not change the economy's fundamental growth rate. This view contrasts with the endogenous growth perspective, which sees taxes, particularly on capital, as potentially impactful depending on how the collected revenue is invested in growth-enabling sectors.

Impact of bank taxes

More specifically on the financial services sector, there has been a growing body of literature on the impact of bank taxes. This literature suggests that such taxes have a range of direct and indirect effects on the banking sector, as well as potential implications for the broader economy. A primary effect of higher bank taxes is the increase in the interest rates charged on loans, which leads to a decline in loan volumes. This reduction in lending has downstream consequences, including a decrease in corporate investment and a suppression of financial market activity, such as interbank lending and market-making[359],[360]. Empirical studies show mixed results when it comes to the impact of bank levies on lending, whereby the effects appear related to the design of the taxation measure. Some studies suggest that levies on liabilities tend to increase lending by decreasing the cost of equity for banks. This is because such levies raise the relative cost of debt funding, incentivising banks to rely more on equity financing. In turn, stronger capitalisation can reduce funding costs and regulatory constraints, potentially supporting an expansion of lending.[361] Other studies show that levies based on assets could have a negative impact on lending.[362]

Additional recent research further refines these insights. Kogler,[363] using cross-country evidence from 23 EU countries, shows that banks tend to pass levies on liabilities onto borrowers by raising lending rates, while simultaneously raising deposit rates – the latter driven by the tax exemption of insured deposits, which incentivises banks to attract deposit funding. The increase in lending rates outweighs the increase in deposit rates, resulting in a net widening of interest margins. The extent of pass-through depends on banks' balance sheet composition, market concentration, and capital structure. Similarly, Sobiech, Chronopoulos and Wilson[364] provide evidence that bank taxation has significant real-economy effects: taxes on bank revenues reduce credit supply, with corporates exposed to taxed banks experiencing lower leverage, higher bond financing costs, and reduced investment activity. Bremus, Schmidt and Tonzer[365] highlight interaction effects between bank levies and corporate income taxes, showing that while levies can promote a more stable capital structure by reducing leverage, these effects weaken in high-CIT environments, where the debt bias of taxation dominates.

Further, higher bank taxes may result in a reallocation of credit towards riskier loans, as banks seek to compensate for higher costs, potentially increasing overall credit risk[366]. The economic effects also extend to households, with taxes potentially leading to higher fees for depositors, especially in concentrated markets where banks have greater pricing power[367]. However, when bank liabilities, excluding deposits, are taxed, banks may increase rates paid on deposits to attract more funding[368].

Additionally, the design of the tax, such as whether it is levied on profits, assets, or liabilities, can significantly influence its economic impact. Taxes on assets or liabilities tend to provide stable fiscal revenue without significantly discouraging banks' investments in cost-efficiency[369]. Conversely, taxes on bank profits or net income may better withstand economic downturns but risk distorting the incentives for banks to take on riskier activities.[370]

The recent debate on windfall taxes introduced in some EU countries during periods of sharply rising interest rates adds a new dimension. D'Angelo, Brighi and Nanni[371] emphasise that such taxes raise complex legal questions under EU and constitutional law but may serve both redistributive and regulatory functions. They argue that, if designed at EU level, windfall taxes could complement monetary policy by reinforcing contractionary decisions of the central bank – though institutional and political hurdles are considerable. Martins,[372] analysing market reactions

to the Spanish and Italian windfall tax announcements, shows that affected banks' stock prices reacted negatively, especially among highly taxed, small and operationally efficient banks. This highlights the potential for such measures to destroy shareholder value and increase perceived risk, raising concerns about their broader financial-market effects.

Recent evidence from the Baltics adds nuance to the discussion over the impact of windfall taxes. A contribution from the Commission's Economic Brief[373] suggests that sector-specific windfall taxes can be compatible with financial stability in well-capitalised systems, but policy design critically shapes distributional and monetary-transmission effects. Lithuania's temporary solidarity levy channelled revenue to a public good with limited distortions, Latvia's borrower relief weakened monetary transmission, and Estonia's dividend-based approach was least distortive yet fiscally modest. Generally, measures tied to public-good financing with clear sunset clauses appear less distortive than broad borrower subsidies or open-ended surcharges.

[354] Blinder, A. S. & Solow R. M. (1976), Does fiscal policy still matter?: A reply, in: Journal of Monetary Economics, Vol. 2, Issue 4, 501-510.

[355] Romer, P. M. (1986), Increasing Returns and Long-Run Growth, in: Journal of Political Economy, Vol. 94, No. 5, 1002-1037.

[356] Xu, B. (1994), Tax Policy Implications in Endogenous Growth Models, in: IMF Working Papers, 1994 (038).

[357] Kim, S-J. (1998), Growth effect of taxes in an endogenous growth model: to what extent do taxes affect economic growth?, in: Journal of Economic Dynamics and Control, Vol. 23, Issue 1, 125-158.

[358] Cooley, T. F. & Hansen, G. D. (1992), Tax distortions in a neoclassical monetary economy, in: Journal of Economic Theory, Vol. 58, Issue 2, 290-316.

[359] Maneely, M. & Ratnovski, L. (2024), Bank Profits and Bank Taxes in the EU, in: IMF Working Paper, WP/24/143, July 2024.

[360] Célérier, C., Kick, T., and Ongena, S. (2020), Taxing Bank Leverage: The Effects on Bank Portfolio Allocation, available at SSRN: https://ssrn.com/abstract=2829326.

[361] Célérier, C., Kick, T., Ongena, S. and Steven R. (2017), Changes in the Cost of Bank Equity and the Supply of Bank Credit. CEPR Discussion Paper No. DP12172, available at SSRN: https://ssrn.com/abstract=3008354.

Burietz, A., Ongena, S. and Picault, M. (2023), Taxing banks leverage and syndicated lending: A cross-country comparison, in: International Review of Law and Economic, Vol. 73.

[362] A recent study by the European Parliament provides a more detailed discussion on the effects of bank taxes as studied in economic literature, see: European Parliament (2025), *The taxation of the EU's financial sector. Options and experiences*, prepared by Atanas Pekanov and Margit Schratzenstaller from Austrian Institute for Economic Research, prepared for FISC Subcommittee. Hereinafter: EP Study (2025).

[363] Kogler, M. (2019), On the incidence of bank levies: theory and evidence, in: International Tax and Public Finance, 26: 677-718.

[364] Sobiech, A., Chronoploulos, D. and Wilson, J. (2021), The real effects of bank taxation: Evidence for corporate financing and investment, in: Journal of Corporate Finance, Vol. 69.

[365] Bremus, F., Schmidt, K. and Tonzer, L. (2019), Interactions between bank levies and corporate taxes: How is the bank leverage affected?, in: European Systemic Risk Board, Working Paper Series, No. 103 / November 2019.

[366] Borsuk, M., Kowalewski, O., and Qi, J. (2023), The dark side of bank taxes, in: Journal of Banking and Finance, Vol. 157.

[367] Capelle-Blancard, G. & Havrylchyk, O. (2017), Incidence of bank levy and bank market power, in: Review of Finance, Vol. 21 (3), 1023-1046.

[368] Buch, C. M., Hilberg, B. and Tonzer, L. (2016), Taxing banks: An evaluation of the German bank levy, in: Journal of Banking and Finance, 72: 52–66.

[369] Puławska, K. (2022), Taxation of the financial sector: Is a bank levy the answer to the financial crisis?, in: Journal of Banking Regulation, Vol. 23, 390-404.

[370] *Ibid.*

[371] D'Angelo, G., Brighi, P. and Nanni, B. (2025), National Windfall Taxes on EU Banks: Legal Aspects and Interplay with Monetary Policy, in: World Tax Journal, Vol. 17 No. 3.

[372] Martin, A. M. (2025), Bank stock market reaction to the Italian and Spanish windfall tax announcement: an event study, in: Journal of Banking Regulation, 26:54-61.

[373] Valentinaite, M., Ceponyte, E. and Zustrups, I. (2025), Taxing Bank Windfall Profits. Lessons from the Baltics, in European Economy – Economic Brief 086 / October 2025, European Commission – Economic and Financial Affairs.

Using a DSGE model calibrated to the Greek economy, Balfoussia and Papageorgiou find that a tax on bank profits constrains credit supply and reduces collateral values through two main channels: a banking capital channel, whereby the tax reduces banks' internal net worth and limits their capacity to extend credit, and a bank funding channel, whereby lower profitability increases deposit funding costs and further tightens lending conditions. The net effect on output is negative, though the authors note that the direct impact is likely limited in the case of Greek banks given their currently high capital adequacy levels.[374]

The imposition of a bank levy has also been shown to discourage cross-border competition, with banks potentially shifting activities to countries with lower tax rates, which highlights the need for a coordinated approach in the EU banking sector[375]. Some empirical evidence shows that cross-country differentials in profit-based bank taxes induce profit shifting from high- to low-tax countries, indicating that implications with financial stability should be monitored. It can be expected that the profit shifting mechanisms used there are also utilised to allocate excess profits to countries with no windfall taxes or generally lower profit taxes.[376] Finally, the macroeconomic effects of bank taxes must be considered in light of their potential to exacerbate market distortions and reduce financial stability, especially in the context of European integration and the Savings and Investment Union (SIU).

Impact of FTTs[377]

FTTs have garnered attention due to their expected positive impact on financial market stability, particularly by reducing speculative and destabilising trades. Advocates of FTTs argue that by targeting speculative trades, these taxes can lower market volatility. However, empirical evidence on the relationship between FTTs and volatility is mixed. While some studies suggest FTTs can increase volatility, others show volatility-decreasing effects. The impact of FTTs on liquidity also remains contested, with studies on the implementation of FTTs in countries like France and Italy suggesting a decrease in liquidity, although these effects are generally modest.

One area where FTTs are likely to have a significant impact is on high-frequency trading (HFT), which has been linked to market destabilisation. Studies show that FTTs can effectively reduce HFT volumes, as seen in Italy and France. However, the broader impact of FTTs on market liquidity and stability is still a matter of debate, with some scholars finding minimal distortions and others noting a potential for reduced market efficiency.

From a revenue perspective, FTTs offer substantial potential due to their broad base, and their ability to generate revenue even at low rates is a key advantage. With that being said, empirical evidence suggests that FTTs can reduce trading volumes by 10% to 30%, particularly in the short term, which could limit their revenue-generating potential. This highlights the need for careful consideration of tax rates and design, as high rates may drive trading to untaxed markets, reducing the tax's overall effectiveness.

7.3.2 Centralisation of input supplies

Over the last decades, across all economic sectors, companies have increased focus on their core activities, while turning to specialised suppliers for inputs: the pendulum between 'make' or 'buy', i.e. whether to produce an intermediate output within a company or purchase it on the market, has moved to 'buy'. By providing the same inputs to multiple players, specialised suppliers can be more efficient, achieving economies of scale, scope, and learning, which in turn spurs innovation. In the financial industry, this centralisation of input supplies has taken two forms: '**groupsourcing'**, when a single entity within a corporate group provides specialised inputs (e.g. providing IT services, accounting, tax) to all parts of the group; and **outsourcing**, when the provision of those support services is externalised to a third party.

[374] Balfoussia, H. and Papageorgiou, D. (2025), Macroeconomic implications of a tax on banks' profits, in: Economic Bulletin, No. 62, Bank of Greece, December 2025.

[375] Haskamp, U. (2017), Spillovers of banking regulation: the effect of the German bank levy on the lending rates of regional banks and their local competitors, in: International Economics and Economic Policy, Vol. 15(2), 449–466,

[376] European Parliament. (2025). The financial transaction tax: State of play and prospects. European Parliamentary Research Service, available at: https://www.europarl.europa.eu/thinktank/en/document/ECTI_STU(2025)772638 (last accessed May 2026).

[377] A more extensive discussion on the economic literature on the impact of FTTs on the financial sector can be found in the 'European Parliament. (2025). The financial transaction tax: State of play and prospects. European Parliamentary Research Service, available at: https://www.europarl.europa.eu/thinktank/en/document/ECTI_STU(2025)772638 (last accessed May 2026), the arguments are summarised here.

This is coupled with the growing importance of IT systems for the financial sector. In the words of several stakeholders 'banks and insurance companies are becoming IT companies that provide financial and insurance services'. This means that, while IT has become more specialised and important across the whole of the economy board, for the financial services sector the phenomenon is even more pronounced.

IT services, as well as all non-financial support services, are subject to standard VAT. Because of the exemption, financial institutions will only deduct part of the VAT incurred on those services (i.e., the portion used to make taxable supplies (and other supplies giving rise to a right to deduct), bearing in mind differences in proportional deduction rules). Hence, compared to industries subject to the standard VAT treatment, **purchasing services from an external supplier, either within or outside a corporate group, is more costly because of the VAT exemption.** More precisely, the additional tax burden, in the form of hidden VAT, amounts to the standard VAT rate on input weighted by the share of non-deductible VAT. Sectoral taxes have no impact on centralisation of input supplies or outsourcing.

In the EU, there is no provision explicitly aimed at reducing this tax burden with respect to outsourcing. In other jurisdictions, this aspect is addressed by either allowing for a (high) fixed deduction rate, e.g., up to 70% in Australia, or by favourable non-legislative agreements on the deduction rules for the banking industry, as in Singapore. In addition, in countries in which the scope of the exemption is narrower (e.g. Japan, or, more significantly so, New Zealand), the higher proportion of taxable outputs to total outputs, often combined with lower standard VAT rates, makes the additional cost of outsourcing lower.

When it comes to groupsourcing, **two partial solutions have existed, namely VAT groups and CSAs (the latter being phased out).** VAT groups eliminate all intra-group VAT, thus allowing the centralisation of input supplies at group level; this can significantly increase the efficiency of centralisation, especially for large groups. However, the scope of VAT groups is strictly national, which means that multinational groups bear input VAT on supplies between the centralised input supplier and their foreign entities. The requirement for strong financial and organisational links means that VAT groups are also not available, in some countries, for cooperative banks. CSAs would eliminate intra-group VAT also in the case of looser group links, as well as, with some limitations, for multinational groups. However, following the CJEU cases[378] they have been eliminated in most EU Member States, which make their cross-border usage practically impossible. Their definitive phasing-out would further reduce the tools for financial institutions to reduce intra-EU VAT; however, with the progressive introduction of VAT grouping, the relevance of CSAs is becoming more and more limited, and, in certain cases, they are more often used for administrative or organisational reason, having been incorporated into VAT groups.

Stakeholders participating to the interviews have largely confirmed the above analysis. **All companies interviewed emphasised that VAT exemption increases the cost of outsourcing or groupsourcing due to the reduced ability to deduct input VAT.** This makes outsourced or groupsourced services more expensive, particularly in areas such as IT, financial business services, and claims handling. As a result, according to stakeholders, businesses are more likely than other sectors to keep services in-house or within their corporate group (where VAT grouping is available) to avoid additional VAT costs.

Several organisations also highlighted that the financial burden associated with outsourcing under the VAT exemption partly discourages them from outsourcing, even when this would be the more efficient business decision. Instead, companies devote significant energy to structuring their operations in a way that brings as much as possible of the value chain in-house or within a VAT group, thus minimising the financial impact of non-recoverable VAT. **That said, in most cases, hidden VAT is perceived as an additional cost more than a driver of business decisions. Most businesses reported that they simply accept the additional VAT cost where outsourcing or groupsourcing is unavoidable**.

Another recurring concern is that the **VAT exemption can act as a barrier to innovation and specialisation**. When businesses are incentivised to develop services internally rather than sourcing them

[378] Judgment of the Court (Fourth Chamber) of 21 September 2017, *Minister Finansów v Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie*, Case C-605/15, ECLI:EU:C:2017:718 ; Judgment of the Court of 21 September 2017, *"DNB Banka" AS v Valsts ieņēmumu dienests*, C-326/15, ECLI:EU:C:2017:719.; Judgment of the Court of 21 September 2017 – *European Commission v Federal Republic of Germany*, Case C-616/15.

from specialist providers, this may limit demand from external suppliers and thus slow down technological advancement. While some companies consider VAT costs a secondary factor in setting business strategy, the overall sentiment is that the VAT exemption imposes financial constraints on outsourcing and groupsourcing. The associated tax burden is widely regarded as a challenge that companies must navigate carefully when determining whether to source services externally or to keep them within the organisation.

7.3.3 Single Market and international competitiveness

Integrating the Single Market for financial services and increasing the competitiveness of the European financial sector are key policy objectives of the EU, as expressed in a number of initiatives, including the following:

- **Capital Markets Union (CMU)**[379]: The CMU was launched with an action plan in 2015 and aims to achieve three objectives: (i) making finance more accessible to EU companies, thus supporting the twin transition; (ii) increase safety for investors and favour long-term investments; (iii) integrate national markets into the Single Market. Taxation is mentioned in the CMU action plan among the barriers to integration of the Single Market needing to be tackled.
- **Savings and Investment Union (SIU)**: underpinned by the Letta and Draghi reports[380] and political guidelines for the current Commission, the SIU Strategy was adopted in March 2025[381]. Building on established CMU foundations, the SIU introduces a distinct citizen focus that moves beyond basic Single Market integration. It aims to mobilise sufficient capital for the EU's most pressing challenges - specifically the digital and green transitions and the enhancement of defence policy - while simultaneously empowering citizens to achieve superior returns on their savings. The SIU Strategy also highlights the importance of taxation, in stressing that differences in national taxation procedures can create administrative burdens and barriers to cross-border investment.
- **Faster and Safer Tax Relief of Excess Withholding Taxes (FASTER) Directive**[382]: seeks to make withholding tax procedures in the EU more efficient and secure for investors, financial intermediaries and national tax administrations.

In addition, the Single Market facilitates cross-border operations through **mechanisms such as passporting**, which allows firms to provide services in multiple jurisdictions under a single license.

➢ *Cross-border trade in financial services*

Despite the progress from a policy perspective, **cross-border trade in the financial services sector remains marginal compared to other sectors**. This section first summarises the state of play, then

[379] The first CMU action plan was adopted in 2015, and a new one was adopted by the Von der Leyen Commission in 2020, with follow-up plans were adopted in 2021 and 2022. Cf. Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions Action Plan on Building a Capital Markets Union, COM/2015/0468 final; Communication from the Commission to the European Parliament, The Council, The European Economic and Social Committee and the Committee of the Regions A Capital Markets Union for people and businesses-new action plan, COM/2020/590 final; Communication from the Commission to the European Parliament, The Council, The European Economic and Social Committee and the Committee of the Regions Capital Markets Union - Delivering one year after the Action Plan, COM(2021) 720 final; Communication from the Commission to The European Parliament, The Council, The European Central Bank and the European Economic and Social Committee A Path Towards A Stronger EU Clearing System.

[380] Von der Leyen U. (2024), Europe's Choice, Political Guidelines for the next European Commission 2024-2029, Strasbourg 18 July 2024, Letta E., (2024), Much more than a market – Speed, security, solidarity. Empowering the Single Market to deliver a sustainable future and prosperity for all EU citizens; and Draghi M. (2024), The future of European competitiveness. Cf. also the Noyer report commissioned by the French Ministry of Finance: Developing European Capital Markets to Finance the Future: Proposals for a Savings and Investments Union (April 2024).

[381] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: *Savings and Investments Union A Strategy to Foster Citizens' Wealth and Economic Competitiveness in the EU*, COM(2025) 124 final.

[382] Council Directive (EU) 2025/50 of 10 December 2024 on faster and safer relief of excess withholding taxes.

considers the extent to which the tax framework poses a barrier to trade across borders, and the implications for competition with firms based abroad.

As shown in detail in Chapter 4 above, import-to-domestic-use-ratio is below 11% for the banking sector and below 8% for the insurance sector. In banking, most retail financial services are provided within national markets, with only a small share of activities truly crossing borders; the relevance of cross-border trade is higher for corporate banking services, especially when it comes to those supplied to very large companies and multinational corporations. Still, foreign banks maintaining a presence in many European markets often do so through locally incorporated subsidiaries or branches rather than through passporting. In the insurance sector, foreign insurers frequently conduct business through subsidiaries licensed under domestic regulations rather than directly engaging in cross-border trade.

In contrast, the investment industry does show a significant share of cross-border trade, with non-domestic funds having a market share of almost 40% of total assets. Funds domiciled in investment hubs, such as Luxembourg, Ireland and Malta, are predominantly marketed to foreign customers. At international level, the high degree of regulation surrounding financial stability, consumer protection, and anti-money laundering compliance makes it difficult for banks to operate purely on a cross-border basis without adapting to local regulatory conditions. Beyond the EU, international trade in financial services face even greater constraints.

Box 10. Trade in the financial sector with third countries

In 2022, total exports of financial services to extra-EU countries amounted to EUR 76 billion, and exports of insurance and pension services to EUR 25 billion. Imports of the same services amount to around EUR 70 billion and EUR 23 billion, respectively, giving a net positive balance of around EUR 5 billion for financial services and EUR 3 billion for insurance. This compares with a domestic market of around EUR 399 billion for financial services and EUR 120 billion for insurance, reinsurance and pension services. Imports thus represent about 19% of the domestic market for financial services and 21% for insurance. Considering both exports and imports, international trade represents respectively about 37% and 40% of the total market.[383]

The **imported content[384] of inputs used to produce financial services is limited**. By measuring the share of imports coming from intra-EU and extra-EU countries over total inputs, the EU share is about 11%, and namely about 10% for banks and insurance sectors, slightly higher for other financial services (13%). It only becomes significant for small countries (such as Cyprus, and Malta, where it is higher than 50%) and international financial centres (such as Ireland, at 43%[385]).

The cross-border trade in financial services in the EU follows distinct patterns depending on whether the providers are based within the EU or in third countries. **In banking and other financial services sector, intra-EU trade is primarily concentrated in fund and asset management services.** In particular, services like custody services, fund distribution, delegated investment management, fund accounting, and certain financial transactions, including Over-The -Counter (OTC) trading and hedging, tend to be concentrated in a few EU financial centres, and hence account for a significant part of intra-EU trade. Financial services imported from third countries are prominent in certain specific areas. For instance, alternative investments, including venture capital and private equity, are frequently sourced from the UK and the US. Many financial institutions rely on third-country providers for derivative products, clearing, and custody services, with London playing a key role in swap clearing. Financial advisory services and transaction clearing services are also commonly imported from non-EU markets. Additionally, payment services, such as credit and debit card processing can be provided by UK and US suppliers. Other specialised financial services, including rating services, economic and financial databases, are typically sourced from third-country providers, particularly in the UK.

[383] Eurostat, Balance of Payments. Data concern NACE sector K64, K65 and K66.

[384] Import intensity is defined as the ratio of inputs over the sector's domestic and imported intermediate use. No split is possible between international and intra-EU trade. Data are taken from Eurostat's Supply and Use Tables.

[385] No data is available for Luxembourg.

Cross-border trade is more limited in the insurance sector. Within the EU, it is possible to provide cross-border insurance services in other Member States, but this is practically impossible in third countries, where a local entity is needed. For most of insurance companies, cross-border insurance policies are marginal and relate primarily to the need to cover local clients abroad.[386] In addition, very specific segments have an international dimension, such as maritime insurance or unit-linked life insurance policies.[387] **Reinsurance** is another service with a strong international dimension, being provided by a few very large companies in the EU. Insurance services sourced from third countries are also largely concentrated in reinsurance, with the Lloyd's market in London playing a dominant role, albeit with actual supplies to EU clients having been partly relocated to the EU after Brexit. Some life insurance policies, including unit-linked products, are offered to EU customers from non-EU jurisdictions such as Bermuda, the UK and Switzerland, often through local brokers or subsidiaries, but this remains marginal.

- ***The tax framework as a barrier to cross-border trade compared to other factors***

Having established that cross-border trade is limited and concentrated in certain segments, the analysis can move to the **role played by the VAT exemption and sectoral taxes** in this context. As analysed in the problem description, the market distortions, fragmented tax framework and accompanying complexity and legal uncertainty, along with brakes on innovation, could combine to increase barriers to trade in the EU Single Market. These could also hamper the global competitiveness of the EU financial sector, which may also face tax competition from third countries in certain situations. At the same time, stakeholders' views differ regarding the relative importance of taxation. Some industry representatives emphasise that persistent tax barriers can fragment capital flows and impede investment. Yet, **financial institutions consulted for the study generally agree that choices of whether to source or supply services from domestic, EU or non-EU locations are primarily driven by other factors**, such as expertise, product availability, and regulatory requirements, in addition to cultural and linguistic factors.

Indeed, while highly specialised financial services are concentrated in a few financial centres, both within and outside the EU, these tend not to receive VAT treatment that differs from services supplied locally. Furthermore, although Brexit resulted in the zero-rating of financial services supplied to and from the UK, this has not led to more services being supplied from the UK, or outweighed the regulatory need to serve EU clients from local subsidiaries, also considering that financial regulators required the use of EU domiciled providers in several instances.

Similarly, **businesses generally do not consider other sectoral taxes to be a major driver in decisions regarding cross-border operations** or the choice of operating location, although in some cases these have been a factor. Bank levies can be particularly relevant in this case, as suggested by the move of Nordea from Sweden to Finland[388] or the possible move of the HSBC headquarter from London.[389]

Differently, IPTs, for example, are the most significant among the identified taxes – both in occurrence and revenue – but appear to have very limited impact on cross-border trade patterns. This is largely due to how the tax is administered: IPTs are levied in the country in which the risk occurs, regardless of where the insurer

[386] E.g. a construction company with a project abroad; a multinational with factories in multiple locations.

[387] Unit-linked insurance policies are life insurance policies in which the policyholder's premiums are invested in a selection of investment funds, and the value of the policy is directly linked to the performance of these funds. Unlike traditional life insurance policies that provide a guaranteed payout, unit-linked policies combine insurance coverage with investment, meaning the returns depend on market performance. They are commonly used for long-term savings, retirement planning, and wealth management, and they can be structured in various ways to offer tax advantages, depending on the jurisdiction.

[388] Johnson, S., & Ahlander, J. (2017, September 6). Banking group Nordea snubs Sweden with HQ move to Finland. Reuters. https://www.reuters.com/article/business/banking-group-nordea-snubs-sweden-with-hq-move-to-finland-idUSKCN1BH28R/ (last accessed May 2026).

[389] HSBC considered moving its headquarter from London to Hong Kong, but eventually did not do so. The move would have put the headquarter closer to the bank major markets', and also saved US$ 14 billion per year in taxes, in particular because of saving the UK bank levy and the different corporate income taxation. Cf. https://www.ft.com/content/be53d3c4-8387-11e9-9935-ad75bb96c849?syn-25a6b1a6=1; https://www.cnbc.com/2016/01/26/hong-kong-hq-move-unlikely-to-slash-hsbcs-tax-bill-reuters-analysis-shows.html

is based. That said, when supplying insurance services to clients in Member States other than where they are based, several of the consulted insurance companies complained about compliance difficulties and the risk of double or non-taxation. Though these difficulties did not pose a significant barrier to cross-border trade, they thought a mechanism similar to the One-Stop Shop used for VAT on B2C cross-border supplies would make it easier to take advantage of the Single Market.

When it comes to **other forms of sectoral taxes, such as bank levies or windfall taxes**, consulted businesses and the economic literature indicate impacts, particularly on profitability. As analysed in the sectoral analysis, the **fragmentation of tax measures targeting the financial sector has further increased in recent years**, not least with the rise of windfall taxes (on profits) as a new type of tax. Recent evidence suggests that such taxes can have material impact on banks' financial performance and may also affect investor perceptions.[390]

Tax-related considerations can arise in specific cases – for instance, when a bank considers whether to enter a new foreign market, the presence of windfall taxes may be relevant. Also, according to some stakeholders, the existence of the VAT option has also played a role in France's financial attractiveness, particularly after Brexit. Some major American banks chose to relocate to France instead of Ireland because of the advantages of the VAT option to tax.

The treatment of supplies between foreign branches and headquarters part of VAT groups also presents a disadvantage for EU operators compared to those established in the most significant financial trading partner, the UK. In the EU, following the Skandia and Danske bank cases[391], supplies from foreign branches to VAT groups are taxable. The UK recently confirmed that it does not follow the Skandia interpretation[392] and does not apply VAT to supplies from foreign branches to British VAT groups. Though subject to anti-avoidance legislation, to a certain extent this reduces hidden VAT on intra-group supplies for multinational financial service providers established in the UK – as well as for any other multinational supplier of exempt services.

At the same time, stakeholders also underlined that **it is not necessarily the existence of a tax burden that weighs most heavily on determining business locations, but rather the certainty and predictability of such burdens**.[393] Tax-related considerations apply as well in the case of locally applicable taxes on the treatment of bonuses and salaries, especially when it comes to the localisation of large international commercial banks. Still, sectoral taxes are often not seen as decisive factors. Even where sectoral taxes create additional cost burdens in certain jurisdictions, businesses emphasised that these are typically absorbed as part of broader financial and strategic planning, rather than altering business structures or location choices.

The **literature on the effects of bank levies is largely in line with such findings**. Bank levies can impact on the lending rate and net margins of banks,[394] and may incentivise banks to adjust their balance sheet structures to reduce tax liabilities. [395] In some cases, tax considerations, including the level and predictability of such levies, have also been cited among the factors influencing location decisions by individual institutions. However, the empirical evidence on the systematic relocation of activities in response to bank

[390] Cf. Risk Assessment Report by European Banking Authority, available at: https://www.eba.europa.eu/publications-and-media/publications/profitability-0?utm. For the case of the Italian windfall tax and its impact on investors, see: https://www.reuters.com/markets/europe/italian-windfall-tax-sends-euro-zone-bank-stocks-tumbling-2023-08-08/?utm.

[391] Judgment of the Court of 17 September 2014, *Skandia America Corp. (USA), filial Sverige*, C-7/13, EU:C:2014:2225. Judgment of the Court of 11 March 2021, *Danske Bank A/S, Danmark, Sverige Filial v Skatteverket, C-*812/19,ECLI:EU:C:2021:196.

[392] HMRC, Revised VAT grouping rules and the Skandia judgment, Published 26 November 2025.

[393] The reasoning being that planning certainty allows incorporating.

[394] Buch, C., Hilberg, B. and Tonzer, L. (2016), Taxing Banks: An Evaluation of the German Bank Levy, in: Journal of Banking and Finance, Vol. 72,52-66. Cf also Kogler, M. (2019), On the Incidence of Bank Levies: Theory and Evidence, in: International Tax and Public Finance, Vol. 26 (4), 677-718.

[395] Puławska, K. (2021), The Effect of Bank Levy Introduction in Commercial Banks in Europe, in: Journal of Risk and Financial Management.

levies remains limited and appears to be more pronounced in specific cases or smaller banking markets, rather than constituting a generalised trend.

From a Single Market perspective, while differences in VAT and sectoral tax treatment exist across Member States, consulted businesses have not considered these substantial enough to drive or act as a barrier to cross-border operations within the EU. Ultimately, while the VAT exemption *does* influence compliance and tax obligations, strategic business considerations remain the dominant factor in determining supplier choice. Even though some jurisdictions provide advantages, e.g. in terms of allowing the option to tax, or taking a broader interpretation of the scope of the exemption for payment or insurance-related services, competitors in other Member States could not identify diverted trade patterns or instances of unfair competition having arisen.

Impacts of the tax framework on international competitiveness

When it comes to competitiveness, the fragmented nature of sectoral taxes naturally results in a preferable tax framework in some Member States over others – such as the absence of any IPT or bank levy. Particular taxes that are not common across the EU, like the payroll taxes in France or Denmark, have led businesses to negatively remark on the ensuing competitive disadvantage. Nonetheless, they were not considered significant enough to deter operations in the respective countries. Evidence can be found on the negative effects of bank levies on competitiveness, but not in relation to business location or forum shopping.[396]

That said, several businesses, particularly banks, highlighted that the **current situation with a high level of fragmentation is not conducive to the cross-border consolidation and mergers.** Although national regulatory and political factors were considered more important, this limits the development of large-scale financial institutions and potentially undermining also the further integration in the Single Market. In addition, as explained in the foregoing section, certain sectoral taxes (in particular bank taxes and FTTs) can also suppress financial market activity and create perverse incentives, which, to a degree, would also undermine the situation of EU financial firms compared to competitors in jurisdictions without such taxes.

The dynamics of the VAT exemption also merit consideration from a competitiveness perspective. **The hidden VAT it results in imposes an additional cost** compared to jurisdictions which do not have VAT at all (e.g. the US), or where the scope of the exemption is narrow or rules for deduction more favourable, or the VAT rate lower (as in Switzerland). Since EU-based financial institutions cannot deduct input VAT on many outsourced services, they face an additional tax burden that non-EU providers, particularly those in jurisdictions allowing (more) input VAT recovery, do not experience.

This **contributes to a lack of neutrality, placing EU firms at a competitive disadvantage** compared to their non-EU counterparts. Some stakeholders note that this effect is particularly visible in services like payment processing, where non-EU providers can offer more competitive pricing as they are not subject to the same VAT constraints. While the VAT exemption is considered as an overall fiscal benefit by many stakeholders, the inability to recover input VAT remains a financial burden, notably on capital spending, for many EU-based firms. This inability concerns both B2B and B2C supplies.

Importantly, this disadvantage only materialises in cases where **EU-based financial institutions compete with services provided by non-EU financial institutions for EU customers**. The disadvantage is greater when such non-EU financial institutions provide services directly from a non-EU establishment, because there is no EU establishment burdened with any hidden VAT. However, the smaller disadvantage remains when services are provided via branches of subsidiaries of non-EU institutions: though hidden VAT can arise on the services provided to the EU establishment, it does not affect general costs borne by the non-EU headquarters. Unfortunately, there is no data available to measure the magnitude of this advantage and other more relevant concomitant factors are at play when it case to international trade flows and relocations, as discussed in Box 11.

[396] Haskamp, U. (2018), Spillovers of banking regulation: the effect of the German bank levy on the lending rates of regional banks and their local competitors, in: International Economic and Economic Policy, Vol. 15, 449-466.

Box 11. Shift in trade flows following Brexit

Available supervisory data suggest that Brexit was associated with a marked reconfiguration of the presence of third-country banks in the EU, in particular through an expansion of balance sheets held by EU-established entities of non-EU banking groups. Data from the EBA indicate that the total assets of EU subsidiaries of third-country banking groups, most notably US-headquartered institutions, increased significantly in the period surrounding the UK's withdrawal from the EU, reflecting the relocation of activities previously conducted from London.

This adjustment has predominantly taken place through the establishment or expansion of subsidiaries, rather than branches. A significant share of business previously carried out via UK-based entities, often through branches passporting into the EU, has been re-booked into EU subsidiaries to maintain access to the Single Market. This has led to a measurable increase in the assets of non-EU banking groups within the EU regulatory perimeter, without necessarily implying a proportional increase in the number or scale of third-country branches.

Source: EBA risk dashboard; Report on the treatment of incoming third-country branches under the national law of Member States

A key contrast relates to **financial services provided to non-EU customers**: like all exports supplied outside the EU, these are zero-rated, and hence the problem of hidden VAT is reduced. It is not fully eliminated, however, because it is not possible to link VAT on general input costs to export transactions, meaning that a certain share of hidden VAT weighs on all supplies of financial services, including those which are zero-rated. This means that the distortive impact of hidden VAT on outsourcing and the resulting disadvantage in using centralised suppliers remain, with, again, a negative consequence on the international competitiveness of EU players.

Still, when it comes to the relevance / scale of the problem, **the role of hidden VAT as a drag on EU competitiveness or as a determinant of international trade was considered limited** by nearly all stakeholders. While acknowledging that hidden VAT represents an additional cost, it is not considered a real driver of international trade, whose determinants remain the regulatory framework, financial specialisation, and the differing demands of clients across countries. In other words, the fact that certain financial services are imported from other EU Member States or third countries while others are mostly sourced and traded domestically has nothing to do with the VAT treatment of such services.

➢ *Conclusions*

The economic analysis leads to several conclusions. Starting with the **economic impacts of different approaches to applying the VAT exemption**, these were examined from both quantitative and qualitative perspectives. Of the provisions assessed, the availability of VAT groups has by far the biggest impact, by providing a means for businesses to reduce hidden VAT on intra-group transactions. This was estimated at EUR 4 to 16 billion, with an additional EUR 160 to 660 million of savings possible if VAT groups were extended to the si Member States still not allowing them. The option to tax also improves the fiscal position of financial services providers (other than insurance services) because it increases the volume of taxed supplies and hence the proportion of input VAT that can be deducted. However, the scale of the impact is only marginal to limited. Differences in the national rules for proportional deduction also have only limited fiscal impacts. While countries allowing only deduction based on the strictest 'actual use' approach show lower deduction levels than those with more liberal approaches, the fact that the vast majority of the financial sector's outputs are exempt puts a ceiling on the potential for further increases. All in all, it can be concluded that variations in the implementation of the VAT exemption do not significantly affect the level playing field.

The **VAT exemption and sectoral taxes both impose administrative costs on financial institutions**, namely in the form of administrative burdens. For VAT, costs for the normally efficient firm[397] have been estimated at about EUR 80,000 for smaller financial institutions[398] (and EUR 240,000 for larger entities. At EU level, total administrative burdens from VAT compliance amount to about EUR 1.3 billion. This represents roughly 1.9% of the VAT liability of the financial sector. VAT compliance would account for

[397] Based on median costs.

[398] Defined empirically this purpose as up to EUR 2 billion turnover.

between 1% and 5% of total regulatory administrative costs, depending on the size of the financial institution. The financial industry also benefits from certain simplifications, the most prominent being reduced invoicing requirements and simpler VAT ledgers, with savings in the area of EUR 200 million. Still, most providers of financial services consider the exemption more complex than standard VAT treatment. This is due, first and foremost, to the legal uncertainty about which services do and do not fall in the scope of the exemption, and also because of the complexity of the rules for calculating partial deduction.

Administrative costs for sectoral taxes are lower, estimated at about EUR 900 million. While the magnitude of the aggregate administrative costs is similar, they are generated by 92 distinct measures. This means, that, all in all, **compliance with sectoral taxes is simpler and less burdensome, although total effort is not negligible.** Considering the average number of sectoral taxes per country and per sector, the annual compliance cost per tax can be estimated at EUR 10,000-25,000 for smaller financial institutions, and at EUR 35,000-70,000 for larger financial institutions. Hence, one single sectoral tax generates a fraction of the administrative costs attributed to VAT: between 10 and 30% for smaller financial institutions, and between 15 and 30% for larger financial institutions. Compared to tax revenue, administrative costs account for about 1.1% of tax revenue from sectoral taxes.

As for **enforcement costs for tax authorities**, although these bring certain challenges (e.g., grappling with the legal uncertainty of whether rapidly evolving financial products and business models are covered by the VAT exemption), these were not assessed as a significant burden. For the VAT exemption, the potential for fraud is held in check by factors such as the highly regulated nature of the sector, and the relatively low VAT liability. Meanwhile, verifying compliance with sectoral taxes is eased by the fact that in many cases the taxable basis relates to information that needs to be provided anyway to comply with financial regulations.

This leads to **wider considerations about the impacts of the tax framework on market behaviour and competitiveness**. The analysis confirms that **the VAT exemption distorts input supplies**, by making outsourcing (and supplies from central entities within a corporate group), more costly. This has become a more serious problem considering the growing tendency to outsource input services, especially IT, or to centralise their supply at group level. This reduces innovation and specialisation. VAT groups partly address this aspect, but only at domestic level. Hence, for cross-border groups, the distortion remains, and it is likely to become more serious the more the Single Market for financial services becomes integrated. Sectoral taxes do not create similar distortions for input supplies, but can affect market behaviour in other ways depending on both the scale and design of specific taxes.

For example, windfall taxes can produce uncertainty and increase perceptions of risk if applied haphazardly; in contrast certain design features, such as links to public-good financing and sunset clauses, can reduce the negative impacts.

Zooming out further, the empirical data show weak negative correlations between higher burdens from hidden VAT and sectoral taxes on the one hand, and profitability on the other. However, the results of the analysis are not statistically significant and should be interpreted very cautiously. The fact that certain taxes, like windfall taxes, tend to be introduced in countries with a profitable financial sector further blurs the picture.

Finally, when it comes to cross-border trade and international competitiveness, **the tax framework, while fragmented and leading to the problems identified in the problem analysis, was not found to be the decisive factor**. This is not to say it plays no role – the existence of sectoral taxes contributes to decisions about business location, especially in case of deciding whether to enter a market. Similarly, hidden VAT imposes a relative cost for EU firms compared to competitors based in jurisdictions without VAT (e.g., the US) or more favourable deduction rules. But this was not perceived as a significant obstacle, and neither VAT nor sectoral taxes, nor the compliance issues associated with these, were found to determine whether financial services are supplied domestically, intra-EU or across third-country borders. Rather, trade patterns for financial services are determined by other considerations, in particular national regulatory frameworks and specialisation. Moreover, while tax fragmentation is not conducive to the cross-border mergers and consolidation that would boost the competitiveness of the EU financial sector, businesses considered other regulatory and political hurdles to be more important.

8. Taxes and the regulatory framework

This chapter places the tax framework in the context of the specific regulatory framework applied to the financial sector. It starts by considering the interaction between the regulatory and tax frameworks in a broad sense, with a view to highlighting the ways they can support each other and identifying potential areas that deserve adequate coordination. The report then discusses how two EU measures for financial stability and crisis management – namely the Single Resolution Fund (SRF) and Deposit Guarantee Scheme (DGS) – are treated for tax purposes.

8.1 Interactions of the tax and regulatory frameworks

Financial institutions are crucial to the whole economy, and their failure can cause significant negative spillover effects for society, including customers, counterparties, investees and credit recipients, as well as public budgets In particular, financial crisis and/or. failures can also have notable negative macroeconomic effects. For this reason, the **financial industry is subject to a prudential regulatory framework**, which is intended to reduce the risk of bankruptcy by ensuring that they possess sufficient resources to withstand negative economic conditions and honour their commitments[399]. In doing this, the prudential regulatory framework contributes to ensuring the stability, resilience and proper functioning of financial institutions and the broader financial system, curbing excessive risk-taking, protecting consumers and depositors, and limiting the likelihood and severity of financial crises.

In addition to prudential regulation, **the financial industry is also subject to a number of other sectoral rules**, concerning investor protection, rules for marketing services to private individuals and consumers, collective and individual safeguards (e.g., the deposit guarantee scheme or the Single Resolution Fund, discussed in Section 8.2 below), and investment requirements. The rules concern not only banks and insurance undertakings – the main targets of the prudential framework – but all actors of the value chain, including e.g., asset and fund managers,[400] insurance and credit intermediaries,[401] and providers of payment service[402].

Most, if not all, businesses in these sectors are subject to authorisation, licensing or notification regimes. Financial services providers are authorised, supervised and regulated by a network of national regulators, including national central banks and authorities as well as European institutions and agencies (the ECB, ESMA, and EIOPA), which vary in their degree of power, from direct supervision to the coordination of national authorities.

This **regulatory framework interacts with the fiscal rules under review across three dimensions**. These are summarised below based on a review of relevant literature[403] and policy documentation, in addition to

[399]The main pillars of the EU regulatory framework are the Capital Requirements Directive and Regulation for banks and Solvency II for insurance. *Cf* Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC Text with EEA relevance; Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 Text with EEA relevance; Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (recast) (Text with EEA relevance).

[400] Cf. i.a. the Directives on UCITS, AIF and ELTIF Regulation. Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast) (Text with EEA relevance); Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 Text with EEA relevance; Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds (Text with EEA relevance).

[401] Cf. i.a. the insurance intermediary Directive. Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast) (Text with EEA relevance) Text with EEA relevance.

[402] Cf. i.a. the Payment Service Directive, Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC (Text with EEA relevance).

[403] A more detailed discussion of literature on the impact of sectoral taxes on financial institutions can be found in Box 15 further above.

the analysis of the economic impacts of the tax framework presented in the previous chapter. Importantly, these dimensions describe the principal channels of interaction between sectoral regulations and taxation This complements the more detailed analysis of economic impacts in Section 7.3 above; particularly Box 12 on the impacts of taxation on the financial sector which can be observed in the literature.

8.1.1 Influence on business decisions

First, taxation can interact with the regulatory framework through its influence on business decisions with potential prudential relevance, including balance-sheet structure, leverage choices and risk-taking incentives. Prudential regulation aims, among other objectives, to define and monitor the types and relative amounts of risk exposure that financial players can undertake, as well as dictating an amount of capital that must be held against liabilities and claims. **Tax rules can indirectly affect decisions regarding these same elements**, by shaping the relative cost of different forms of financing and activities.

For example, traditional corporate income taxation (CIT) typically allows interest on debt to be deducted, while taxing returns on equity. This asymmetry can (especially at a high tax rate) incentivise debt financing over equity and thus interact with regulatory objectives related to leverage and resilience. To counteract this, some countries have introduced an 'allowance for corporate equity' into their CIT rules that rebalances the incentives by granting a notional deduction on equity as well.[404] The literature on the taxation of banks provides further illustration of this and similar interactions. For example, Bremus, Schmidt and Tonzer show that bank levies can influence banks' capital structure by reducing leverage, but that these effects interact with the CIT environment and tend to weaken in high-CIT settings, where the bias towards debt financing dominates.[405]

Other studies suggest that higher bank taxes may be associated with changes in banks' lending strategies, including a reallocation of credit towards riskier exposures as institutions try to offset higher costs.[406] Sobiech, Chronopoulos and Wilson[407] provide evidence that taxes levied on bank revenues are associated with a contraction in credit supply, with corporates exposed to taxed banks exhibiting lower leverage, higher bond financing costs and reduced investment activity. Beyond lending to the real economy, the literature also points to a suppression of wholesale financial market activity, including interbank lending and market-making.[408] From a regulatory perspective, these findings are relevant insofar as they illustrate how fiscal measures applied to banks can transmit to the real economy through balance-sheet adjustments and financing conditions, affecting leverage dynamics beyond the banking sector itself.

These findings illustrate the potential interaction of taxation with regulatory objectives that focus on leverage, credit allocation and financial stability. In particular, changes in lending conditions induced by taxation may alter firms' financing choices and risk profiles, which are variables monitored by supervisors when assessing systemic risk and macro-financial conditions. At the same time, the magnitude and direction of such effects depend on the design of a tax, the structure of financial markets and broader macroeconomic conditions, underscoring the need for caution in drawing general conclusions.

The **specific base on which a sectoral tax is levied – assets, liabilities, or profits – is therefore a key parameter from a prudential perspective**, as each design transmits through a different channel to bank balance sheets. As discussed in Box 9, taxes on assets or liabilities tend to provide more stable fiscal revenue, but interact more directly with prudential variables. Levies on liabilities, in particular, can raise the relative cost of debt funding and thereby incentivise banks to rely more on equity financing, with stronger capitalisation in turn lowering funding costs and easing regulatory constraints, potentially supporting an

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404 The deduction is usually calculated as: Equity Base × Notional Interest Rate. Cf. Klemm A., Allowances for Corporate Equity in Practice, IMF Working Paper, WP/06/259 (2006).

405 Bremus, F., Schmidt, K. and Tonzer, L. (2019), Interactions between bank levies and corporate taxes: How is the bank leverage affected?, in: European Systemic Risk Board, Working Paper Series, No. 103 / November 2019.

406 See for example: Borsuk, M., Kowalewski, O., and Qi, J. (2023), *The dark side of bank taxes*, in: Journal of Banking and Finance, Vol. 157.

407 Sobiech, A., Chronoploulos, D. and Wilson, J. (2021*), The real effects of bank taxation: Evidence for corporate financing and investment, in: Journal of Corporate Finance, V*ol. 69.

408 See Box 9.
Célérier, C., Kick, T., Ongena, S. and Steven R. (2017), *Changes in the Cost of Bank Equity and the Supply of Bank Credit*. CEPR Discussion Paper No. DP12172, available at SSRN: https://ssrn.com/abstract=3008354.

expansion of lending. Asset-based levies, by contrast, have been associated with a contraction in lending. Taxes on profits or net income tend to better withstand economic downturns, as the base contracts when banks' earnings fall, but they may distort risk-taking incentives by encouraging banks to seek higher-return – and therefore riskier – activities to offset the burden. These design-specific channels are directly relevant to the prudential framework, as they shape both the composition of bank funding and the risk profile of bank assets, which are the central variables of capital and leverage regulation.

Indeed, it should also be emphasised that **taxation and prudential regulation pursue distinct, different policy objectives**. Prudential regulation is the adequate policy instrument for maintaining an appropriate level of risk-taking by financial institutions, and the two policy areas are not seen as substitutes for each other. Prudential regulation focuses on risk management and the resilience of institutions, while taxation primarily serves revenue and distributional objectives, while behavioural incentives play a smaller role. Nevertheless, because both frameworks can affect similar balance-sheet variables, it is important that their potential side effects are taken into account in parallel. This is illustrated by the ECB's opinions on national windfall taxes, in which it cautioned that poorly designed measures could reduce retained earnings, limit credit institutions' ability to build capital buffers, and impair monetary policy transmission (see Box 9 and Section 6.7 for further details) – concerns that straddle both the prudential and fiscal domains. This interaction has, at times, also been further acknowledged at EU level, for example in the Commission's proposal for a financial transaction tax, which was framed as complementing prudential regulation by addressing excessive risk-taking alongside revenue and fairness objectives (see Box 12 below).

Beyond such high-level policy considerations, similar interactions can also arise through more technical features of the tax system. In this respect, certain fiscal rules can directly affect the level of capital requirements (and hence interact with sectoral regulations). To give an example, deferred tax assets allow credit institutions to carry forward past losses and offset them against future profits, thereby reducing corporate income tax once profitability is restored. From a tax perspective, this treatment is generally considered appropriate, as it ensures that taxation is based on net income over time rather than penalising temporary losses. From the perspective of prudential regulation, however, deferred tax assets may be treated more conservatively, because they depend on future profitability rather than providing immediate loss-absorbing capacity. Consequently, recognition of deferred tax assets for capital requirement purposes can differ between their fiscal and their regulatory treatment, and between countries. The differing prudential and fiscal treatment of deferred tax assets across different Member States is, therefore, a potential source of distortions for financial institutions in the EU.

Box 12. The interrelation between taxes and regulation in the Commission's proposal for an EU financial transaction tax (FTT)

FTTs are a typical example of a tax which aims to serve the multiple goals, namely generating revenue, ensuring fair taxation *and* reducing excessive risk-taking. This is made explicit from the first recital of the Commission's FTT proposal,[409] from 2011: *"The recent financial crisis has led to debates at all levels about a possible additional tax on the financial sector and in particular a FTT. This debate stems from the desire to ensure the financial sector contribute to covering the costs of the crisis and that it is taxed in a fair way vis-à-vis other sectors for the future; to dis-incentivise excessively risky activities by financial institutions; to complement regulatory measures aimed at avoiding future crises and to generate additional revenue for general budgets or specific policy purposes".*

No agreement was found on this Proposal, which led 11 Member States to request the Commission to proceed with an enhanced cooperation.[410] This subsequent Proposal2013 [411], however, did not progress, also considering the shifting policy context, with the aftermath of the financial crisis becoming less salient and the focus of EU action moving towards enhancing growth and competitiveness. The Commission's Work Programme for 2026 foresees the official withdrawal of the 2013 proposal.

[409] Brussels, 28.9.2011 COM (2011) 594 final 2011/0261 (CNS) Proposal for a Council Directive on a common system of financial transaction tax and amending Directive 2008/7/EC.

[410] Namely, Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia. Estonia withdrew its participation in 2016.

[411] Brussels, 14.2.2013 COM (2013) 71 final 2013/0045 (CNS) Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax.

8.1.2 Impacts of taxation on profitability

Second, taxation can interact with the regulatory framework through its influence on profitability, internal capital and/profit generation capacity and ultimately the attractiveness of financial institutions to investors. Prudential regulation requires financial services companies to hold minimum amounts of capital, while profit is one of the means of generating this (as well as the main means for remunerating the investors providing the capital). It follows that any significant variation of the fiscal burden on the sector can affect the capacity of financial companies to generate and maintain sufficient regulatory capital. Relatedly, an increase in the tax burden could lead to concomitant demands for relief from prudential requirements, to avoid undermining the competitiveness of the sector. This illustrates the importance of establishing a structural dialogue between prudential requirements and taxation.

Section 7.3 assessed in depth the impacts of the tax framework on business performance in the financial sector. This found weak negative correlations between tax burdens (either from hidden VAT or sectoral taxes) and profitability. However, since the results are not statistically significant, they should be interpreted with caution.,. At the same time, recent supervisory evidence from the EBA points to a clearer short-term profitability effect from sectoral taxes: comparing June 2023 with June 2024, it found that "other expenses, including taxes" reduced EU/EEA banks' RoE year-on-year by 80 basis points, which the EBA considers likely attributable at least in part to heightened taxation on banks, including windfall taxes, in some Member States.[412] While the stakeholders' consultation showed that banks and banking federations support lower taxes, this was mainly for competitiveness purposes.

More evidence on this topic is available from the literature and focuses on sectoral taxes, as discussed in detail in Section 7.3.1[413]. For example, a paper by Kogler demonstrates that bank levies on liabilities tend to be passed on to customers through higher lending rates, while at the same time being associated with higher deposit rates – the latter driven by the tax exemption of insured deposits, which incentivises banks to attract deposit funding as a relatively cheaper source.[414] The net effect of this pass-through mechanism is a widening of banks' net interest margins, because the increase in lending rates outweighs the increase in deposit rates. This **suggests that the impact of sectoral taxes on profitability is not uniform and depends on market structure, balance-sheet composition and the competitive landscape**. Higher bank taxes have also been found to lead to a reallocation of credit towards riskier loans, as banks seek to compensate for higher costs, a dynamic with potential financial stability implications. The economic effects also extend to households, with taxes potentially translating into higher fees for depositors, particularly in concentrated markets where banks have greater pricing power (see Box 9). From a regulatory perspective, these findings are relevant insofar as changes in net interest margins affect both internal capital generation and banks' responses to monetary policy.

Windfall taxes have received particular attention in this context, given their introduction in several Member States during periods of sharply rising interest rates. From a regulatory and financial stability perspective, the ECB has cautioned that such measures may reduce retained earnings and thereby limit credit institutions' ability to build capital buffers and absorb future shocks, potentially affecting credit quality and resilience. The ECB has also highlighted the risk that uncoordinated national measures could fragment the internal market, distort competition, and create double-taxation concerns for cross-border banking groups. From a monetary policy perspective, the ECB has warned that poorly designed windfall taxes could impair monetary policy transmission by constraining banks' capacity to adjust lending conditions or maintain adequate capital and provisions during downturns.[415]

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[412] Risk Assessment Report by European Banking Authority, available at: https://www.eba.europa.eu/publications-and-media/publications/profitability-0?utm.

[413] See in particular D'Angelo, G., Brighi, P. and Nanni, B. (2025), National Windfall Taxes on EU Banks: Legal Aspects and Interplay with Monetary Policy, in: World Tax Journal, Vol. 17 No. 3.

[414] Kogler, M. (2019), *On the incidence of bank levies: theory and evidence*, in: International Tax and Public Finance, 26: 677-718.

[415] See a set of ECB opinions:

At the same time, the literature and recent experience suggest that the interaction between windfall taxes and financial stability is highly dependent on tax design and institutional context. D'Angelo, Brighi and Nanni emphasise that, while windfall taxes raise complex legal and constitutional questions, they may, if carefully designed, serve redistributive or macroeconomic stabilisation purposes.[416] Complementing this, Martins, analysing market reactions to the Spanish and Italian windfall tax announcements, shows that affected banks' stock prices reacted negatively, with the strongest effects observed among highly taxed, small and operationally efficient banks. This points to a potential destruction of shareholder value and an increase in perceived risk, which is directly relevant from a prudential perspective, as it affects banks' cost of capital and their attractiveness to investors – and, by extension, their ability to generate and retain regulatory capital.[417] Evidence from the Baltics further suggests that sector-specific windfall taxes can be compatible with financial stability in well-capitalised banking systems, though design choices are critical.[418] In this respect, measures with clear sunset clauses and revenues earmarked for public goods appear less distortive than broad-based relief schemes or open-ended surcharges, which may weaken monetary transmission or create distributional inefficiencies. Windfall taxes can also amplify contractionary effects during periods of restrictive monetary policy.[419]

The **interaction of the VAT exemption and the regulatory framework has received comparatively little attention** and it is not covered in the existing literature. However, to the extent that the exemption distorts behaviour and complicates compliance, a similar logic would apply. For example, the input distortions caused by hidden VAT also increase the relative cost of outsourcing, preventing businesses from maximising efficiency and undermining the strength of the sector[420]. The higher administrative costs compared to standard VAT treatment pose an additional operational risk. That said, these aspects need to be considered against the reduced overall tax burden that results from the exemption, meaning that its impacts on the ability of financial firms to meet their requirements are likely to be limited.

Taken together, these considerations do not imply that higher taxation is inherently incompatible with financial stability, nor that lower taxation necessarily supports prudential objectives. **Rather, they highlight that taxation and prudential regulation interact in multiple ways, meaning that the design, timing and two-sided coordination of prudential and fiscal measures matter**. From this perspective, the key issue is not the overall level of taxation, but whether potential side effects on regulatory objectives are taken into account alongside broader fiscal, monetary and stability considerations. The opposite also stands true. This nuanced assessment is in line with the wider literature on sectoral taxes and their impact on the financial sector presented in Box 9 further above. A recent example of this is shown in the results from the

- ECB, Opinion of the European Central Bank of 26 November 2019 on increasing the special levy on selected financial institutions, CON/2019/40.
- ECB, Opinion of the European Central Bank of 2 November 2022 on the imposition of temporary levies on certain credit institutions, CON/2022/36.
- ECB, Opinion of the European Central Bank of 12 September 2023 on the imposition of an extraordinary tax on credit institutions, CON/2023/26.
- ECB, Opinion of the European Central Bank of 4 April 2023 on the imposition of a temporary solidarity contribution, CON/2023/9.

[416] D'Angelo, G., Brighi, P. and Nanni, B. (2025), National Windfall Taxes on EU Banks: Legal Aspects and Interplay with Monetary Policy, in: World Tax Journal, Vol. 17 No. 3.

[417] Martin, A. M. (2025), Bank stock market reaction to the Italian and Spanish windfall tax announcement: an event study, in: Journal of Banking Regulation, 26:54-61.

[418] Valentinaite, M., Ceponyte, E. and Zustrups, I. (2025), Taxing Bank Windfall Profits. Lessons from the Baltics, in European Economy – Economic Brief 086 / October 2025, European Commission – Economic and Financial Affairs.

[419] See in particular Fatica, S., Heynderickx, W., and Pagano, A, (2020), Banks, debt and risk: assessing the spillovers of corporate taxes, in Economic Inquiry, Vol. 58, No 2.

[420] AFME - Kpmg (2026), Bank Taxes in Europe - Examining the effects of banking taxes on banks, the macroeconomy and competitiveness, available at: https://www.afme.eu/publications/reports/bank-taxes-in-europe-eu-and-uk/ (last accessed April 2026).

Commission's Economic Brief on windfall taxes[421], which outlines the potential compatibility of sector-specific windfall taxes with financial stability in well-capitalised systems, provided that policy design takes into account potential side effects and interplay with prudential regulation.

8.1.3 Combined effects on the Single Market

Thirdly, taxation and regulation can interact through their combined effects on the Single Market. The **regulatory framework for financial services remains characterised by a significant national dimension**. As shown in the stakeholders' consultation, regulatory barriers play a prominent role compared to VAT and sectoral taxes in determining business models, and how and the extent to which different types of financial services are traded across border. This persists despite EU initiatives such as the CMU and SIU strategies introduced above, which aim inter alia to enable the realisation of the Single Market for financial services.

At the same time, **tax differences can *compound* existing regulatory fragmentation**. While, as noted above, sectoral taxes are generally not seen as decisive drivers of location decisions or cross-border activity, the literature on bank levies suggests that cross-country differences in sectoral taxation may influence the location of activities and discourage cross-border competition, with banks potentially shifting activities or profits towards lower-tax jurisdictions.[422] Empirical evidence indicates that differentials in profit-based bank taxes can induce profit-shifting behaviour across Member States, and similar mechanisms may apply in the context of windfall taxes or other sector-specific surcharges.[423] While these effects depend on tax design and enforcement, they illustrate how uncoordinated fiscal measures can interact with regulatory fragmentation to affect the allocation of financial activity within the EU, making the implications for financial stability a factor worth monitoring.

Regulation can also have a direct impact on taxation proceeds, notably where levies or contributions are introduced as part of the financial stability architecture. This is the case for **regulatory contributions linked to deposit protection and resolution frameworks, such as DGS and SRF (discussed in Section 8.2 below)**, whose design, base and collection are shaped by regulatory objectives rather than general revenue considerations. While these contributions are not taxes, they interact with national tax systems and contribute to the overall financial burden faced by financial institutions. The interaction between regulatory objectives and fiscal treatment in this area is discussed in more detail in the following section.

Conversely, **greater coordination or harmonisation of fiscal rules can support the smooth functioning of the EU economic space**. This is emphasised in the 2020 Action Plan for "fair and simple taxation supporting the recovery strategy"[424], which included an explicit reference that the European Commission is considering potential changes to the VAT exemption for financial services, with a view to reducing complexity, legal uncertainty, and costs for sector operators and, ultimately, their customers.

8.2 The tax treatment of contributions to the Single Resolution Fund and Deposit Guarantee Scheme

Following the discussion of the interactions between taxation and the regulatory framework above, this section examines in more detail two regulatory instruments that appear somewhat close to sectoral taxes in their nature. While, importantly, these contributions are explicitly not taxes, they represent a financial obligation for certain institutions and are collected at the national level under an EU-wide framework. The two contributions analysed in this section are to the **Single Resolution Fund (SRF)**, which finance the resolution of failing banks within the Banking Union, and those to the **Deposit Guarantee Scheme (DGS)**,

[421] Valentinaite, M., Ceponyte, E. and Zustrups, I. (2025), *Taxing Bank Windfall Profits. Lessons from the Baltics*, in European Economy – Economic Brief 086 / October 2025, European Commission – Economic and Financial Affairs.

[422] Haskamp, U. (2017), Spillovers of banking regulation: the effect of the German bank levy on the lending rates of regional banks and their local competitors, in: International Economics and Economic Policy, Vol. 15(2), 449–466.

[423] European Parliament. (2025). The financial transaction tax: State of play and prospects. European Parliamentary Research Service. https://www.europarl.europa.eu/thinktank/en/document/ECTI_STU(2025)772638 (last accessed May 2026).

[424] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: An action plan for fair and simple taxation supporting the recovery strategy, COM(2020) 312 final.

which ensure depositor protection in case of bank failures, and. These contributions operationalise the EU's shared approach to financial-crisis prevention and resolution, but their implementation varies by Member State.

In particular, despite being based on harmonised EU legislation, national authorities oversee the collection, management, and application of these contributions, leading to differences in implementation. In the context of the DGS contributions, while some parameters are set at the EU level, Member States retain discretion in certain aspects, resulting in a certain fragmentation in how these contributions are handled from a tax and administrative perspective. This study examines these differences, with a particular focus on the **treatment of the contributions under corporate income tax rules**, specifically their deductibility. Additionally, the analysis considers payment methods and VAT treatment, as these elements can contribute to administrative complexity and, possibly, to fragmentation across the EU. The VAT treatment of the contributions has only been discussed with the Member States in the fieldwork sample, while income tax treatment is also analysed for the other countries.

The findings presented in this section are based on responses from 21 Member States, gathered through the stakeholder consultation and written survey of tax authorities. Responses from the remaining Member States were not received in time for this report but will be integrated. The analysis remains incomplete at this stage also due to limited availability of expertise on these contributions within VAT-focused units of tax authorities.[425] Nonetheless, the collected data provides valuable insight into how these contributions are implemented across the EU, shedding light on the degree of harmonisation – and fragmentation – associated with these financial stability mechanisms.

8.2.1 Single Resolution Fund

The SRF is an emergency fund designed to support the resolution of failing banks within 21 Member States, including the 20 Eurozone countries and Bulgaria.[426] Their responses, if provided, were included in the below analysis for completeness. The SRF was established in the aftermath of the financial crisis of 2007-09, to ensure that the financial sector plays an active role in stabilising the financial system.[427] The SRF has been built up over eight years (2016-2023), reaching its initial target level of at least 1% of covered deposits at the end of 2023. Importantly, the build-up of the SRF is done via regulatory contributions from the affected banks, and not via a taxation measure. **As of 2023, the fund contained around EUR 77.6 billion**, with annual contributions collected from over 2,777 credit institutions and investment firms across the Banking Union in its latest cycle.[428]

Since the SRF has now reached its initial target, regular contributions have been suspended for the time being. However, the fund remains subject to ongoing assessments by the Single Resolution Board (SRB), which will determine whether additional contributions are needed in future. If the available financial means of the SRF fall below the target level – due to a significant increase in covered deposits or the use of the fund in resolution cases – new contributions may be required from banks. Figure 67 breaks down the annual contributions to the SRF between 2016 and 2023, as reported by the SRB.

While the SRF contribution methodology was designed to be risk-based, empirical evidence suggests that in practice, contributions correlate more strongly with banks' total assets than with their risk profile.

[425] In a few fieldwork Member States, the lack of insight from tax authorities could be complemented with feedback from private sector stakeholders – for example on the direct tax treatment.

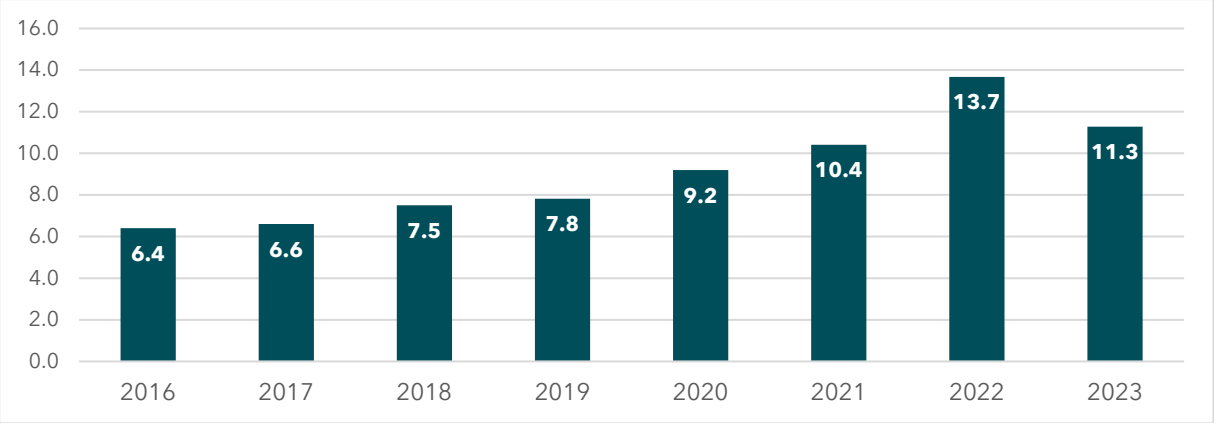
[426] For basic information on the SRF, see website of the Single Resolution Board, SRB, available at: https://www.srb.europa.eu/en/single-resolution-fund; last accessed in February 2025. For the purpose of the study, information was sought from all27 Member States, knowing that some of them might operate domestic funds of a similar nature.

[427] Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010.

[428] According to SRB publication from July 2023, available at: https://www.srb.europa.eu/en/content/single-resolution-fund-grows-eu113-billion-reach-eu-776-billion; last accessed at February 2025.

According to a CEPS study[429], the calibration of the risk-based adjustment factors has had only a limited impact on the distribution of contributions, implying that size remains the dominant determinant.

Figure 67. Annual contributions to the SRF (in EUR billion)



Source: Authors' elaboration based on SRB data, at: Link

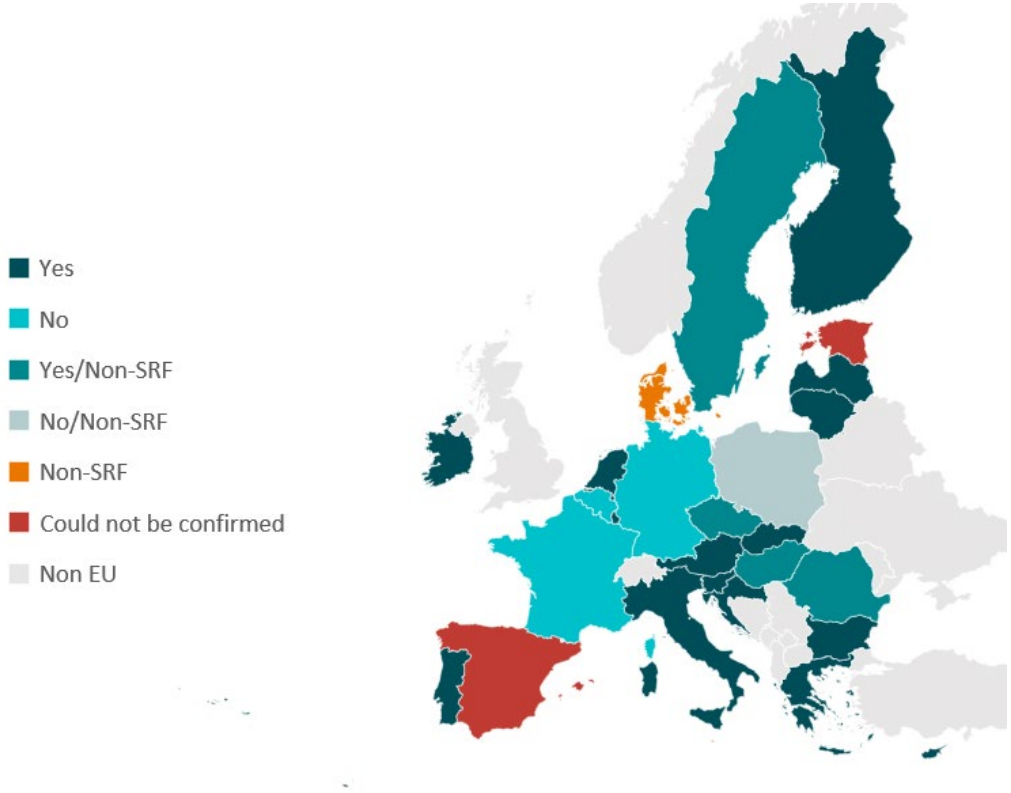
Although the SRF is an EU-level instrument, contributions are collected at the national level, with national resolution authorities overseeing the process before transferring funds to the SRF. While some Member States integrate SRF contributions into their domestic bank levies, the targeted consultation and sectoral tax research suggest that this remains the exception rather than the rule. In Germany, for example, a national bank levy existed between 2011 and 2015, but this was later merged with the levy feeding into the SRF. Following the SRF reaching its target level, Germany no longer applies a general national bank levy, though specific protection schemes remain in place for certain banking sectors, such as savings banks. Other Member States take different approaches, with some continuing to apply their domestic bank levies even beyond the filling of the SRF; in this case, bank levies finance the public budget.

A key aspect of the analysis of the national implementation of SRF contributions is their treatment under Corporate Income Tax (CIT). In the **vast majority of Member States** for which information was available, **financial institutions are allowed to deduct SRF contributions as an operating expense** before pretax income, meaning that these payments reduce their taxable income. However, in several Member States, SRF contributions are not tax deductible, namely in Germany, France, and Belgium as well as in Poland for the contributions to their domestic resolution fund.[430] In Germany, for example, financial institutions have raised concerns over the higher effective tax burden resulting from this treatment. During the targeted consultation, certain German credit institutions emphasised that the non-deductibility of SRF contributions increases their overall tax liability. Such differences in treatment create some fragmentation in the financial sector's tax burden across the EU. The direct tax treatment of SRF contributions across the EU is summarised in Figure 68.

[429] CEPS – De Groen, W.P. and Oliinyk, I. (2021), How to Refine the Contributions to the Single Resolution Fund? Proposal for an Alternative Methodology.

[430] In Belgium, this reflects a change introduced as part of the 2023 budget measures, under which the non-deductibility of the bank tax was increased from 80% to 100%, see: https://febelfin.be/en/press-room/supervision-policy/government-opts-for-new-tax-on-savings; (last accessed May 2026).

Figure 68. Treatment in direct taxation of SRF contributions or national equivalents (tax deductible or not)



Source: Authors' elaboration based on 2025 legal mapping

Payment terms for SRF (or national equivalents) contributions vary across Member States, with some countries allowing alternative payment methods beyond standard cash payments. According to the information gathered, Germany, Cyprus, Hungary, Latvia, and Slovakia require SRF contributions to be paid in cash. This is also the standard in Italy and France, but both authorities allow for irrecoverable payment commitments (IPC) backed by collateral arrangements. In contrast, Austria, Belgium, Czechia, Finland, and the Netherlands allow for IPCs, provided that they are fully backed by collateral consisting of low-risk assets. In these cases, the share of IPCs is generally capped at 30% of the total contributions raised. Similarly, Slovenia allows for a combination of cash and IPCs.

When it comes to the VAT treatment of the SRF contributions, some differences among the fieldwork Member States arose. In Malta and Greece, SRF contributions are treated as exempt supplies of financial services, while Lithuania classifies them under the insurance services exemption. The remaining covered countries, including Germany, France, Italy, and the Netherlands, consider SRF contributions to be outside the scope of VAT, meaning that they are not considered supplies from a VAT perspective.

8.2.2 Deposit Guarantee Scheme

The DGS is a key financial stability mechanism in the EU, ensuring that depositors are protected in the event of a bank failure.[431] Under EU rules, all Member States are required to operate a national DGS, guaranteeing deposits up to EUR 100,000 per depositor, per institution. While the level of minimum protection is harmonised across the EU,[432] the funding, collection, and administration of DGS contributions are managed at the national level, leading to variations in implementation and payment mechanisms.

Since 2015/2016, banks have been required to contribute annually to their respective national DGS funds, with Member States obliged to reach a funding level of at least 0.8% of the insured deposits. Eight Member States (Belgium, Bulgaria, Estonia, Croatia, Luxembourg, Malta, Poland, and Romania) have opted for

[431] For basic information on the DGS, see for example website of EBA, available at: https://www.eba.europa.eu/activities/single-rulebook/regulatory-activities/depositor-protection/deposit-guarantee-schemes-data (last accessed in February 2025).

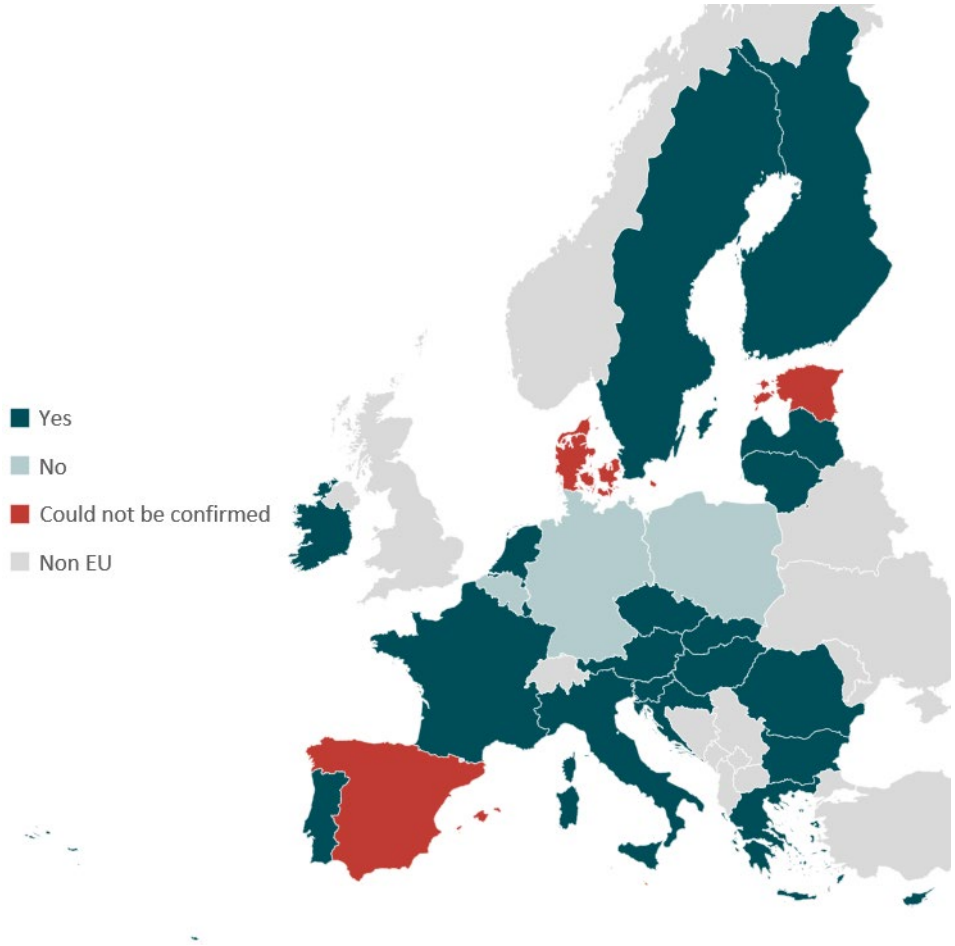
[432] Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes.

higher targets, ranging from 1.0% in Bulgaria to 2.7% in Romania. France was the sole Member State granted a lower target, setting its level at 0.5%. These differences in funding targets add to the fragmentation in how DGS contributions are structured across the EU.

In the sampled Member States, **contributions to the national DGS are primarily paid by banks**, which are the main contributors across all countries. Insurance companies are generally excluded, except in Malta and Belgium, where certain life insurance companies are also required to contribute. Investment firms are required to participate in some jurisdictions, such as Belgium and Czechia, where investment companies operating outside the EEA must contribute if equivalent protection is not provided. Asset and fund managers are required to contribute to the DGS only in Germany and France, provided they are authorised to receive funds from depositors. Additionally, other financial institutions, such as investment companies, are required to contribute in Latvia, Slovakia, Lithuania, Malta, Poland, and under specific conditions in Greece and Italy, if they qualify as deposit-taking entities. In Slovenia, the scheme covers banks headquartered in the country, while branches of third-country banks may also be included under specific conditions.

The tax deductibility of DGS contributions largely mirrors that of the SRF contributions. **In most Member States, financial institutions can deduct DGS contributions as an operating expense** before pretax income, reducing their taxable income. In fact, from the countries for which information could be retrieved, **only Belgium, Germany, and Poland do not allow such deductions**, resulting in a higher effective tax burden for banks operating in these jurisdictions. Unlike the SRF, France does allow tax deductibility for DGS contributions. Figure 69 shows the direct tax treatment of DGS contributions across the EU.

Figure 69. Treatment in direct taxation of DGS contributions (tax deductible or not)



Source: Authors' elaboration based on 2025 legal mapping

The payment terms for DGS contributions largely follow the same approach as SRF contributions. In Germany, Cyprus, Hungary, Latvia, and Slovakia, cash payments are required. This is also the standard method in Italy and France, although Italy allows for IPCs backed by collateral arrangements, and France

also allows registered, non-negotiable certificates that transfer pecuniary rights. Austria, Belgium, Czechia, Finland, and Slovenia allow for a combination of cash and IPCs, with the share of IPCs typically capped at 30% of total contributions.

For VAT treatment, available data suggests that most Member States classify DGS contributions as outside the scope of VAT, as is the case in Germany, France, Italy, the Netherlands, Poland, and Sweden. However, in Malta, Lithuania, Spain, and Greece, DGS contributions are treated as exempt supplies of financial services. This should have implications for VAT revenue, in that out of scope contributions would not be considered for the purposes of calculating the proportional deduction, while hidden VAT results from supplies of exempt services. However, private operators did not report on either of these cases as problematic or otherwise.

While DGS contributions were not widely considered to generate significant administrative burdens, some stakeholders pointed to fragmentation in implementation across Member States. Concerns were particularly noted in countries where high sectoral tax burdens already existed, such as Belgium, where DGS and SRF contributions add to a complex layering of financial sector taxes. Additionally, some stakeholders questioned the justification for differences in target levels, noting disparities such as France's 0.5% target level compared to higher levels in other countries. Another issue was raised by credit institutions that are members of specific investor protection schemes, such as savings banks or cooperative banks. These banks highlighted a potential misalignment between their own security systems and the DGS and SRF, also noting that they would potentially not benefit from EU-wide schemes as their own setup would be activated first in case of need. Moreover, German institutions noted that tax treatment is not aligned, with contributions to their institutional saving scheme being deductible but DGS or SRF contributions not.

PART B – Problem analysis, policy objectives and considerations

Part B builds on the assessment of the current situation by synthesising the evidence gathered into a structured analysis of the problems associated with the current taxation framework for the financial sector, together with the policy objectives and considerations that could guide a possible future initiative.

Chapter 9 presents the **problem analysis**, identifying the main drivers, problems and consequences arising from the existing VAT exemption and related sectoral tax framework, as well as their likely evolution under a dynamic baseline scenario in which current policies remain unchanged. Given its function as a self-standing synthesis, the chapter necessarily draws on and summarises evidence presented throughout Chapters 2 to 8 in Part A.

Building on this analysis, **Chapters 10 and 11 set out the policy objectives and the key considerations** that could be explored in the context of a future reform. To facilitate the analysis, the policy considerations are grouped into three broad "building blocks":

- Building block 1 – Modernisation and simplification of the current rules of VAT
- Building block 2 – Introduction of measures to reduce non-deductible VAT borne by the financial sector; and
- Building block 3 – Revisiting the VAT exemption for financial services and introducing harmonisation measures in sectoral taxes

Together, these chapters provide the conceptual framework for the subsequent assessment of impacts and comparison of policy considerations presented in the remainder of the study.

9. Problem analysis

9.1 Introduction

Part A of the report assessed the current tax framework for the financial sector under business, legal, sectoral and economic angles. This chapter brings together the different strands of analysis with a view to determining whether and to what extent the tax framework is problematic for stakeholders and society. As such, **it does not present new information but rather summarises and regroups the findings from the previous chapters into a self-standing narrative** [433].

In so doing, the problem analysis aims to demonstrate whether and how the prevailing situation could merit the consideration of new action at EU level, as well as setting a baseline against which the impacts of policy scenarios for the future will be compared. The analysis takes into account the VAT exemption for financial services and other sectoral taxes applied to the financial sector, and examines their scale, causes and consequences for different stakeholders, as well as their likely evolution without further EU action. By way of introduction, an initial 'bird's eye view' presents an overview of the issues at stake, followed by the problem tree, description of the stakeholders affected, the policy context, and, due to its importance for the analysis, a summary of the salient features of the VAT exemption. The rest of the chapter then focuses on the drivers, main problems and consequences of the current situation.

9.1.1 A 'bird's eye' view

Several overarching issues can be highlighted to set the scene before presenting and substantiating the problem analysis in detail.

The first is the **outdatedness of the VAT exemption for financial services**. While VAT is normally levied on the goods and services (i.e., outputs) supplied by a taxable person acting as such, many jurisdictions chose to exempt financial services from output VAT; this was due to the difficulty of defining the tax base on services priced in terms of interest-rate spreads and other implicit charges. This includes the EU, which exempts financial services in Article 135(1)(a-g) of the VAT Directive. Instead of taxing outputs, VAT revenues in the financial sector are generated mainly from the tax revenues due on inputs; because of the exemption, businesses bear the cost of non-deductible VAT rather than enjoying the right of deduction that ordinarily ensures fiscal neutrality as a cornerstone of the fractioned payment system. Since this cost does not appear on invoices and cannot be recovered further in the supply chain, it is known as 'hidden' VAT.

Aside from being outdated, **the VAT exemption causes a range of problems**. When it comes to VAT revenues, the annual VAT policy gap provides an indication by comparing actual VAT liabilities with a theoretical situation whereby the same financial services were taxed (and input VAT deducted). Though a simplification[434], this is estimated at EUR 52.2 billion in 2023 (representing 4.4% of EU VAT revenue). In part to make up for the revenue shortfall, the Member States have gradually subjected the financial sector to a range of other taxes, such as Insurance Premium Taxes – IPTs, in place in most Member States.

Market distortions are also inevitable, because providers of financial services face a fiscal barrier to outsourcing parts of the value chain, even when this would be more efficient. This is because hidden VAT is borne as a cost on purchased inputs, raising costs as well as disincentivising investment in innovative practices and specialisation. These issues are becoming worse over time due to the financial sector's complex and constantly evolving value chains. Technology has played a very large role in this, transforming

[433] Chapter 2 of this report explains that, while the study is not a formal impact assessment support study, it does follow the Better Regulation principles. These include the analysis of the problems caused by the current policy framework, and their drivers and consequences, as step towards determining the objectives and policy considerations (i.e., potential policy measures) that could comprise a future policy initiative. Cf. Better Regulation Toolbox, notably Chapter 2 therein on how to carry out an impact assessment.

[434] A full assessment of the impacts on VAT revenues, demand and other indicators is presented in Chapter 14 for policy considerations that would remove or partly remove the VAT exemption, alongside the retention or removal of related sectoral taxes, based on specialised economic models.

the variety of services offered, how they are produced and delivered, and who provides them; while large, full-service firms still account for much of the market share, specialist firms are driving innovation and occupying increasingly important niches.

The VAT exemption has also necessitated a **complex and shifting framework to support implementation**. This includes **various structural provisions** introduced in the VAT Directive to reduce distortions, and the classification challenges of defining exactly which services should be exempt. Related to this, the Member States have also taken different approaches to implementation, engendering **fragmentation** that, while not currently assessed as a major factor, could hold back efforts to realise the EU Single Market for financial services and boost the competitiveness of European firms. The sectoral taxes mentioned above, which vary in terms of mechanism, tax base, tax rate and other factors, are an additional source of fragmentation. All of this increases **administrative costs**. The fragmentation is further compounded by the introduction of sectoral taxes, such as the above-mentioned IPTs and other taxes such as the salary taxes applied to VAT-exempt (and certain other) sectors in some Member States. As the ensuing analysis shows, these problems are sufficiently serious as to merit exploration of how they might be resolved.

Moreover, against this backdrop, a parallel development is that digitalisation has vastly improved tax administration and compliance systems in recent years, which means that **bringing much of the financial sector into the VAT base has become practically feasible**. This is evidenced not just from theoretical research, but by the practical experiences of many jurisdictions outside the EU orbit, including countries with advanced financial systems such as Australia, Singapore and Japan. It has thus become harder to justify the exemption on technical grounds, calling into question the continued relevance of the VAT exemption. The exceptional nature of the VAT exemption, and third-country approaches, are described under Driver 1 below, while approaches to taxing financial services are discussed in Section 5 on policy considerations for potential future changes.

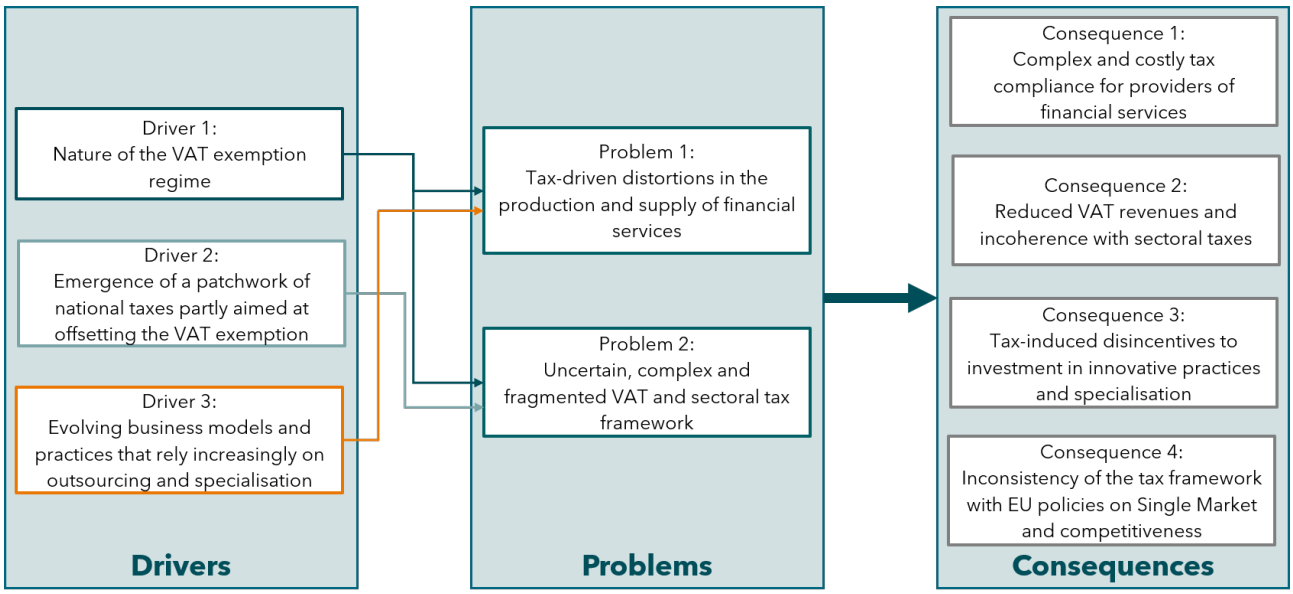
9.1.2 Problem tree

The starting point for assessment is the problem tree depicted in Figure 70 below, which can be summarised as follows:

- **The drivers or 'root causes' of the problems**: three drivers have been identified: (i) the VAT exemption departs by design from the general VAT rules and was introduced in order to address practical difficulties in taxing the financial services which are no longer fully valid; (ii) in part to compensate for the VAT exemption, Member States have introduced a patchwork of national sectoral taxes that vary significantly across the EU; (iii) business models in the financial sector have evolved, with value chains increasingly dependent on outsourcing, specialisation, and cross-border service provision – developments that the existing VAT framework does not accommodate effectively.
- **Problems**: the drivers lead to two main problems. Firstly, due to the VAT exemption, providers of financial services lose the right of deduction, which in turn means that many of the sector's input purchases are taxed. This breaks the principle of VAT neutrality in the value chain, resulting in tax-driven distortions. Secondly, the VAT exemption and the way it is applied, combined with the patchwork of sectoral taxes, cause legal uncertainty, complexity and fragmentation between Member States in the way financial services are taxed.
- **Consequences**: the problems have four distinct consequences for stakeholders and society as a whole, namely (i) tax compliance in the financial sector is unnecessarily complex and costly for firms, increasing their cost base; (ii) VAT revenue is reduced since outputs are not taxed, while interactions with sectoral taxes are sometimes incoherent, in particular for the insurance sector, where IPT revenues often exceed that that would be expected from VAT on outputs; (iii) providers of financial services are discouraged from investing in innovative practices and specialisation that depend on outsourcing, since this comes with an additional tax burden; and (iv) in perpetuating fragmentation and stymying innovation and specialisation, the tax framework is also inconsistent with EU policies

aiming to facilitate trade in the Single Market and boost the competitiveness of the EU financial sector.

Figure 70. Problem tree for the taxation framework for the financial sector



Source: Authors' elaboration

9.1.3 Stakeholders affected

The financial sector touches virtually every aspect of the economy, serving as the backbone of investment, savings, payments, and risk management activities. To the extent that the tax framework influences the behaviour, structure, and development of this sector, it can be said to affect directly or indirectly all economic operators and citizens in the EU. This is because taxation shapes not only how financial institutions operate but also how financial products are designed, priced, and distributed to customers.

The most directly affected stakeholders fall into three main groups: Member State tax authorities, providers of financial services, and consumers.

1. **Tax authorities** are responsible for implementing, enforcing, and monitoring the taxes applicable to financial activities. They must ensure compliance, prevent tax avoidance, and maintain the balance between generating fiscal revenues, creating a healthy business climate and minimising compliance and enforcement costs.
2. **Providers of financial services** must comply with these tax obligations while managing their operational costs, competitiveness, and profitability. The tax framework influences their strategic decisions, from product design to market expansion.
3. **Buyers of financial services** – households, businesses, and investors – are ultimately impacted by how taxes shape the cost, availability, and attractiveness of financial products and services. For example, taxes can affect the net interest rates offered on savings, the price of insurance premiums, returns on investments, and the accessibility of credit. In other words, the structure and level of taxation of the financial sector have profound impacts on the wider economy and behaviour of EU businesses and consumer.

In addition, suppliers of intermediate inputs to providers of financial services, including of digital services, are also indirectly affected due to the impacts of the VAT exemption on input costs and decisions of financial services providers to outsource inputs or produce them in-house.

Given the great diversity of the providers of financial services (and their supply chains), it is necessary to categorise them for analytical purposes. For the purposes of this analysis, the financial sector is considered in terms of three broad categories: banking, insurance, and other financial services (comprising mainly investment services and asset management). Each of these categories exhibits distinct characteristics which

are summarised in Table 38 below and further detailed in Chapter 2- business model analysis and typology and Chapter 4 - business and sectoral analysis.

Alongside these three main categories, **fintech**, short for "financial technology", is a cross-cutting sector which is transforming how financial services are produced and delivered, enabling new value chains and increasing efficiency. Fintech business models span payments, embedded finance, robo-advising, AI applications, crowdfunding, crypto services, insurtech, enabling technologies like open banking, and RegTech, all contributing to a dynamic and increasingly diverse financial ecosystem. Fintech innovations can be broadly divided into two categories: business-to-consumer (B2C) services and business-to-business (B2B) solutions. B2C fintech offerings primarily focus on removing traditional intermediaries, enabling consumers to access financial products and services more directly, efficiently, and at lower cost. In contrast, B2B fintech solutions concentrate on improving operational efficiency within financial institutions and enterprises by streamlining back-end processes, enhancing data integration, and automating routine workflows.

Table 38. Categories of financial services

Categories	Overview and subcategories	Key metrics
Banking services	Services covering activities such as credit, deposits, payments, foreign exchange, and investment activities. Two main sub-categories can be identified: retail banking and wholesale banking. **Retail banking** (B2C and B2B – small businesses) provides services including deposits and loans, trading and ForEx, wealth management, leasing and other niche services. Among retail banks there are also **cooperative** banks. These are different from other banks because their members govern them and they mainly provide services in the local area or sector that they serve. **Wholesale banking** (B2B/B2G – large corporations, public entities, and financial institutions); typical services include, treasury services (liquidity, payments, deposits, large-scale loans); Investment banking (shares, bonds, derivatives, M&A, capital issuance); Brokerage and advisory services. In capital markets, Automated Trading Systems and Blockchain (Distributed Ledger Technology) are used to streamline trade execution, settlement, and record-keeping. Finally, **payment services** have always been offered by banks, but now are also supplied by specialist payment service providers (PSPs) as part of more complex value chains involving multiple actors. Within the banking services, **retail fintech solutions** provide access to credit, deposits and payments in a more flexible and often cheaper way. In the **B2B segment**, fintech companies provide back-end solutions such as accounts, payments, and card issuance to start-ups, e-commerce platforms, and software providers. This simplifies regulatory compliance and infrastructure requirements.	**GVA:** EUR 468 bn (2023) **EU net turnover**: EUR 904 bn (2023) **Number of companies**: 4,788 (2023) **Customer breakdown**: businesses were the largest consumers, accounting for 73.4% of total banking expenditures, followed by households at 21.6% and the public sector at 5.1%. **Cross border trade**: trade is predominantly domestic, with foreign participation limited to specific segments and cross-border activities are typically conducted through locally incorporated subsidiaries; • median export-to-total-supply ratio: 9.3%; • median import-to-domestic-use ratio: 10.6%
Insurance services	Services based on offering risk management to customers in the form of insurance contracts. These services provide coverage against risks in exchange for a premium, offering compensation if the risk is realised. This category comprises: • **Life insurance**: covering the risk of death in terms of payment of a designated beneficiary upon the death	**GVA:** EUR 117 billion (2023) **EU net turnover**: EUR 1,240 bn (2023) **Number of companies**: 3,636 (2023) **Customer breakdown**: households were the main

	of the policyholder, often associated with an investment component • **Non-life insurance**: covering liability, property and health risks among others • **Insurance intermediation**: involving intermediaries like agents or brokers, who facilitate the conclusion, amendment, or termination of insurance contracts • **Reinsurance**: insurance for insurers, helping to distribute risk and protect insurers from large losses • **Other insurance-related services**: services are ancillary to the main insurance transaction and include claims handling, damage assessments, in-kind restoration services, premium collection, customer support, and IT management Insurtech services are rapidly changing how risk is managed, distributed, and priced. B2C insurtech solutions e.g. digital-insurance platform that let customers compare and purchase insurance policies online enable consumers to access and manage insurance more directly and digitally, and often with less effort, than through traditional insurance distribution. Insurtech services are also offered in a B2B context, notably through collaborations with traditional insurers. These collaborations may involve the provision of technological solutions, such as automated and data-driven tools, to support insurers' distribution and claims management processes.	insurance consumers (62.1%), followed by businesses (35.0%) and the public sector (2.9%). **Cross border trade**: trade is predominantly domestic, with limited foreign participation and cross-border activities are typically conducted through locally incorporated subsidiaries. • median export-to-total-supply ratio: 7.6% • median import-to-domestic-use ratio: 7.6%
Other financial services	Concern the management of collective or individual investments. This category comprises two main subcategories: **Fund management**: involves running collective investment funds for retail or professional investors. Fund management can be provided by specialised fund managers or firms also offering a range of financial services, including banks. **Asset management**. managing investments on behalf of clients such as individuals, corporations, financial institutions, or public entities. Financial companies, such as insurance firms and banks, rely on asset managers for managing their funds or those entrusted by clients. Services can be provided in-house or outsourced to specialised firms. Finally, other financial services also include **enablers**. These are firms that do not directly manage investments or funds, but instead provide essential services such as security custody, trade execution and the operation of financial exchanges or clearing houses. In this type of financial service, the role of fintech includes the growth of robo-advisors – digital platforms that enable investment management for both retail and professional clients, and RegTech innovations.	**GVA:** EUR 124 billion (2023) **EU net turnover**: EUR 220 billion (2023) **Number of companies**: number of investment firms: 6,910 (2024) number of funds (both UCITIS and AFIs): 57,497 (2024) **Customer breakdown**: businesses accounting for 90.5% of total spending (EUR 257.6 billion). B2C and B2G segments were much smaller, at 8.8% (EUR 25.1 billion) and 0.7% (EUR 2.0 billion) **Cross border trade**[435]: UCITS cross-border funds marketed in EU exceed domestic funds, essentially intra-EU, with almost 70% of UCITS being sold across borders from hubs in Ireland and Luxembourg. Asset management clients are mainly domestic, although intra-EU clients grew during the last years.

[435] The available data does not allow for a direct analysis of the export-to-total supply and import-to-domestic use ratios, as was done for banking and insurance services.

In 2023, the EU financial sector contributed around 4.2% to the EU GDP, generating approximately EUR 700 billion in gross value added (GVA)[436]. Although the sector's GVA has grown steadily from EUR 500 billion in 2011 to EUR 700 billion in 2023 – an average annual growth rate of 2.7% – its share of GDP has slightly declined from 4.5% to 4.2%, meaning a small decrease in relative importance. Banking activities remain dominant, accounting for nearly two-thirds of total GVA in 2022, while insurance and other financial services each contribute about one-sixth. At the Member State level, Luxembourg stands out with financial activities representing over 21% of its GDP, while other financial hubs such as Malta and Cyprus record around 10%. Most other Member States fall closer to the EU average of 4–5%, reflecting the sector's varied significance across the region[437].

The **level of cross-border activity varies by sector**. Banking and insurance services are mostly supplied domestically. To the extent that foreign companies are active in this area, they tend to operate via local subsidiaries or branches, or under the Freedom to Provide Services (FPS) legislation for insurance[438]. In banking, EU Member States typically export services worth 9% of sectoral output, while importing about 11%. However, countries with higher imports also tend to export more, and this pattern becomes very pronounced in financial centres such as Ireland, Luxembourg and Cyprus. Ireland stands out in particular, with export and import shares above 100%, which indicates strong "re-exporting" activity – services are purchased from abroad and then sold on to other countries rather than used domestically. A similar picture emerges for insurance services. For most Member States, exports and imports each account for around 8% of the market. But again, the most internationally oriented economies – especially Ireland, Luxembourg and Malta – show much higher levels of cross-border activity. As for other financial services, the fund industry is essentially intra-EU, with almost 70% of UCITS being sold across borders from hubs in Ireland and Luxembourg.

In terms of **customer breakdown**, nearly three-quarters (73%) of banking services are supplied to businesses, followed by 22% to households and around 5% to governments. The proportion of B2B services is even higher in other financial services, where supply and use tables (SUT) suggests it accounts for 90% of services, with the remaining 10% split between households (9%) and governments (1%). By contrast, a much larger proportion of insurance services (62%) are supplied to consumers, with 35% supplied to other businesses and around 3% to government bodies. However, there is some variation between countries within this broadly consistent picture[439].

Fintech initially focused on consumer-facing tools such as e-banking, digital wallets, and mobile payments, has evolved into advanced solutions like open banking, digital currencies, and payment infrastructures, often termed "Fintech 3.0." By automating processes, reducing intermediaries, and leveraging AI and data analytics, fintech companies lower costs and expand access to financial services. Globally, the sector is projected to reach about EUR 1.29 trillion in revenues by 2030, up from EUR 275 billion in 2024[440], though growth has recently slowed due to reduced levels of venture capital investment. In Europe, fintech is valued

[436] Eurostat's National Accounts aggregates by industry [nama_10_a64].

[437] Authors' calculations based on Eurostat datasets nama_10_gdp available at https://doi.org/10.2908/NAMA_10_GDP and nama_10_a64 available at https://doi.org/10.2908/NAMA_10_A64,. For more detailed analysis see Section 4.2.

[438] The main objective of the Third Council Directives Nos 92/96/EEC (life assurance) and 92/49/EEC (non-life insurance) is to allow any insurer authorised in a Member State to carry on its insurance activities throughout the European Union, whether under the rules on branches or under the freedom to provide services. See also the Interpretative communication of the Commission concerning the freedom to provide services and the general good of the insurance sector [Official Journal C 43 of 16.02.2000].

[439] Authors' calculation based on Eurostat FIGARO - EU Inter-Country Use Tables (EU IC-SUIOTs). For more detailed analysis see Section Annex 3.

[440] BCG Global. «Global Fintech 2024: Prudence, Profits and Growth». https://www.bcg.com/publications/2024/global-fintech-prudence-profits-and-growth. $1.5 trillion in revenues by 2030, up from $320 billion in 2024.

at about EUR 75 billion (2023)[441] and is expected to rise to EUR 351 billion by 2032, with Northern Europe—particularly Sweden, Ireland, the Netherlands, Estonia, and Denmark—leading in scale and innovation.

9.1.4 Policy context

Integrating the Single Market for financial services and increasing the competitiveness of the European financial sector are key policy objectives of the EU, as expressed in a number of initiatives, including the following:

- **Capital Markets Union (CMU)[442]**: The CMU was originally launched with an action plan in 2015 and aims to achieve three objectives: (i) making finance more accessible to EU companies, thus supporting the twin transition; (ii) increase safety for investors and favour long-term investments; (iii) integrate national markets into the Single Market. Taxation is mentioned in the CMU action plan among the barriers to integration of the Single Market needing to be tackled.
- **Savings and Investment Union (SIU) Strategy**: underpinned by the Letta and Draghi reports[443] and political guidelines for the new Commission, the SIU Strategy was adopted in March 2025[444]. Building on established CMU foundations, the SIU introduces a distinct citizen focus that moves beyond basic Single Market integration. It aims to mobilise sufficient capital for the EU's most pressing challenges - specifically the digital and green transitions and the enhancement of defence policy - while simultaneously empowering citizens to achieve superior returns on their savings. The SIU Strategy also highlights the importance of taxation, in stressing that differences in national taxation procedures can create administrative burdens and barriers to cross-border investment.
- **Faster and Safer Tax Relief of Excess Withholding Taxes (FASTER) Directive**[445]: seeks to make withholding tax procedures in the EU more efficient and secure for investors, financial intermediaries and national tax administrations.
- In addition, the Single Market facilitates cross-border operations through **mechanisms such as passporting**, which allows firms to provide services in multiple jurisdictions under a single license.

9.1.5 Key concepts and the functioning of the VAT exemption for financial services

Before discussing the drivers, problems and consequences in detail, it is important to provide an overview of VAT as a concept, and the VAT exemption applied to the financial sector[446].

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[441] IMARC Group «Europe Fintech Market Size, Trends & Statistics Report 2032». https://www.imarcgroup.com/europe-fintech-market.

[442] The first CMU action plan was adopted in 2015, and a new one was adopted by the Von der Leyen Commission in 2020, with follow-up plans were adopted in 2021 and 2022. Cf. Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions Action Plan on Building a Capital Markets Union, COM/2015/0468 final; Communication from the Commission to the European Parliament, The Council, The European Economic and Social Committee and the Committee of the Regions A Capital Markets Union for people and businesses-new action plan, COM/2020/590 final; Communication from the Commission to the European Parliament, The Council, The European Economic and Social Committee and the Committee of the Regions Capital Markets Union - Delivering one year after the Action Plan, COM(2021) 720 final; Communication from the Commission to The European Parliament, The Council, The European Central Bank and the European Economic and Social Committee A Path Towards A Stronger EU Clearing System.

[443] Von der Leyen U. (2024), Europe's Choice, Political Guidelines for the next European Commission 2024-2029, Strasbourg 18 July 2024, Letta E., (2024), Much more than a market – Speed, security, solidarity. Empowering the Single Market to deliver a sustainable future and prosperity for all EU citizens; and Draghi M. (2024), The future of European competitiveness. Cf. also the Noyer report commissioned by the French Ministry of Finance: Developing European Capital Markets to Finance the Future: Proposals for a Savings and Investments Union (April 2024).

[444] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: *Savings and Investments Union A Strategy to Foster Citizens' Wealth and Economic Competitiveness in the EU*, COM (2025) 124 final.

[445] Council Directive (EU) 2025/50 of 10 December 2024 on faster and safer relief of excess withholding taxes.

[446] The specifics of other taxes applied to the sector are described as part of Driver 2 below

VAT is a broad-based consumption tax levied on most goods and services purchased by private consumers and other persons defined as "non-taxable", like hospitals and certain other organisations operating in the public interest. However, instead of being charged only on these goods and services, VAT is as accounted for a fractionated tax levied on the 'value added' at each stage in the supply chain. It is collected from businesses through a system of partial payments: at each stage, a VAT liable person remits the VAT due on their taxable supplies ("output VAT"), while deducting the VAT on their purchases ("input VAT"). Along with detailed reporting requirements, this mechanism reduces the risks of fraud, while ensuring that the tax is neutral with respect to both the length of the supply chain and the number of transactions involved.

The exemption departs from this general approach. **Based on Article 135(1)(a)-(g) of the VAT Directive, most financial services fall into the category of exempt VAT supplies**. As a result, VAT is not charged on most financial services outputs, which in turn means that financial services providers cannot deduct the VAT incurred on taxable inputs, whether these be highly specialised IT services or more generic costs like cleaning services or office equipment. Table 39 below shows how the financial services defined as exempt in the VAT Directive map to the typology categories outlined in the previous section.

Table 39. Typology of financial services and activities covered by the VAT exemption

Categories	Activities	VAT exemption Article 135(1)
Insurance services (Insurers and reinsurers)	Insurance	(a) insurance and reinsurance transactions, including related services performed by insurance brokers and insurance agents
	Reinsurance	
Insurance services (Insurance intermediaries)	Insurance intermediation	
Insurance services (Insurers, insurance intermediaries, and other companies)	Insurance supporting activities	
Banking and other financial services (Banks and other financial service providers)	Granting of credit (e.g. consumer, mortgage and corporate credit)	(b) the granting and the negotiation of credit and the management of credit by the person granting it (c) the negotiation of or any dealings in credit guarantees or any other security for money and the management of credit guarantees by the person who is granting the credit
	Negotiation and management of credit and credit guarantees	
Banking services (Banks, payment service providers)	Deposit accounts	(d) transactions, including negotiation, concerning deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments, but excluding debt collection (e) transactions, including negotiation, concerning currency, bank notes and coins used as legal tender, with the exception of collectors' items, that is to say, gold, silver or other metal coins or bank notes which are not normally used as legal tender or coins of numismatic interest
	Current accounts	
Banking and other financial services (Banks and other financial service providers, payment service providers)	Payments, currency transactions, cheques and other negotiable instruments	
Banking and other financial services (Banks and other financial service providers, asset and fund managers	Transactions in shares, interests in companies or associations, debentures and other securities	(f) transactions, including negotiation but not management or safekeeping, in shares, interests in companies or associations, debentures and other securities, but excluding documents

		establishing title to goods, and the rights or securities referred to in Article 15(2);
Other financial services (Asset and fund managers)	Management of collective investment funds	(g) the management of special investment funds as defined by Member States;

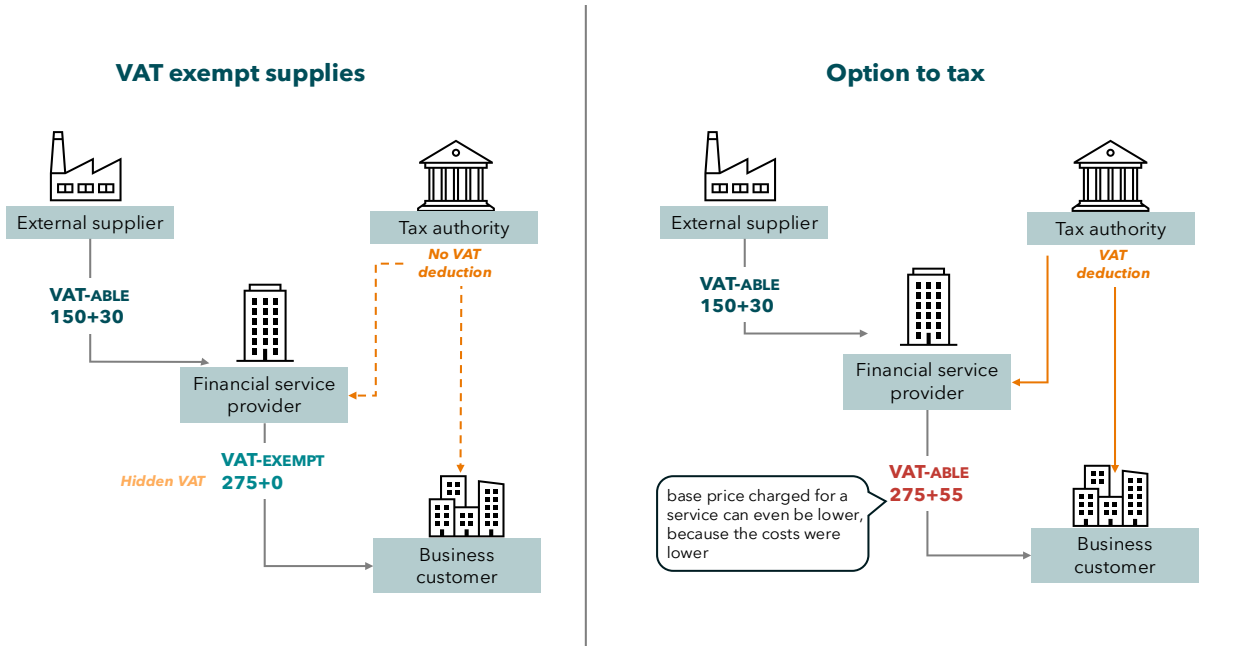
Since providers of exempt services cannot deduct input VAT, this becomes a cost, often referred to as 'hidden' VAT, because it increases costs in the value chain without appearing directly on customer invoices. Business customers are particularly affected, as they bear the full cost of any 'hidden' VAT passed on by service providers instead of paying VAT on the purchase price, which they would normally deduct as input VAT.

To mitigate the costs and the distortions introduced by the non-deductibility of input VAT, the Directive provides for a number of **structural provisions** that help to reduce hidden VAT, which are shortly described below. After a basic description, each of these provisions is illustrated by diagrams that, while simplifications, illustrate the dynamics at play and the impacts on actors in the value chain, in hypothetical situations where: VAT is charged at a 20% rate; the supply involves an input cost of EUR 150, internal production costs of EUR 80 and mark up to the customer of EUR 45.

- **Option to tax**. Article 137(1)(a) allows (but does not require) the Member States to allow providers of financial services to choose to charge VAT on certain supplies that otherwise would be exempt. Member States applying the option can decide on aspects such as which financial services are covered (though it is not open to insurance services), and whether the options should be exercised at entity or transaction level. When the option is exercised, providers enjoy the right to deduct the VAT incurred on the relevant inputs, which they normally cannot do when making exempt supplies. Given the choice, providers typically charge VAT to their business customers, which can then deduct the input VAT and reduce costs, while continuing to exempt services provided to consumers and other non-taxable persons.

Figure 71. The option to tax reduces costs for providers of financial services and their customers subject to VAT

Note: The example is based on a supply involving: (i) Input cost of EUR 150; (ii) Internal production costs of EUR 80; (iii) Mark up to the customer of 45; (iv) VAT charged at 20%

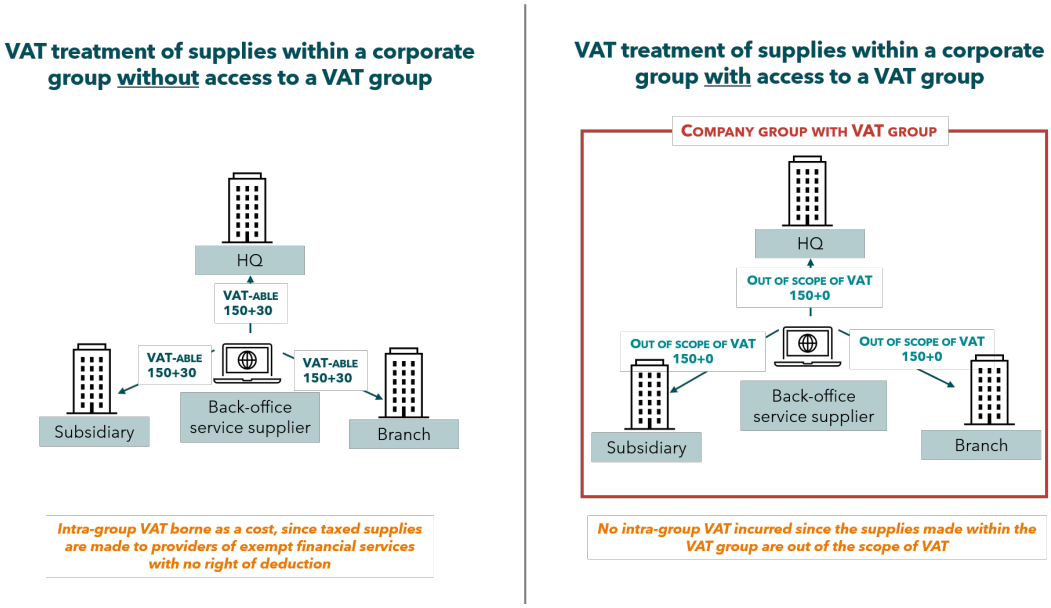


Source: Authors' elaboration

- **VAT groups**. Article 11 of the VAT Directive permits Member States to treat a group of 'legally independent' persons 'closely bound to one another by financial, economic, and organisational links as a **single taxable entity for VAT purposes**, i.e., as a 'VAT group'. Entities within the same corporate group often make supplies to each other. While these transactions are financially neutral in other respects, without a VAT group VAT needs to be charged on them, which cannot be deducted, due to the exemption thereby increasing their costs (the non-deductible VAT). VAT groups eliminate VAT on intra-group transactions, which become out-of-scope of VAT, similarly to intra-company transactions. In the case of a financial service provider, for instance, purchasing services from a non-financial intra-group supplier (such as a shared back-office service provider without a VAT group, means that the VAT charged on those services would be irrecoverable given the supplier's exempt status. Conversely, within a VAT group such transactions fall outside the scope of VAT altogether, thereby eliminating the hidden VAT. That said, VAT groups provide only a partial solution to the problem of hidden VAT, because they may only consist of entities established within the same Member State and therefore cannot be applied on a cross-border basis, even within a single corporate group. Moreover, the provision does not provide relief for input VAT incurred on purchases from external third-party suppliers. VAT groups are currently available in 22 Member States.

Figure 72. VAT groups eliminate intra-group transactions and members are treated as a single taxable person

Note: The example is based on a supply involving: (i) internal supplies with a value of EUR 150 and a VAT rate of 20%



Source: Authors' elaboration

- **Cost-Sharing Arrangement (CSAs)**[447], allow for an entity to be set up by a group of taxable persons for the joint provision of services to the members of the group on a cost-sharing basis. CSAs are gradually being phased out following the 2017 DNB BANKA and Aviva judgments[448] stating that Article 132(1)(f) of the VAT Directive is not applicable, inter alia to the financial service industry. The CJEU stated that Article 132(1)(f) of the VAT Directive is applicable only to independent groups of persons carrying out an activity in the public interest, i.e., those listed in the

[447] Article 132(1)(f) of the VAT Directive.

[448] Cf CJEU judgments of 21 September 2017, *DNB Banka*, C-326/15, EU:C:2017:719: Cf also Judgment of the Court of 21 September 2017, *Minister Finansów v Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie*; Case C-605/15; ECLI:EU:C:2017:718.

same Article 132[449]. Consequently, providers of other exempt services, such as financial services, are no longer entitled to benefit from the CSA exemption. The role of CSAs largely overlaps with VAT groups (as illustrated above), and where available are used in a similar fashion, with the additional benefit (for CSAs) of being able to include members in multiple Member States, thereby allowing the reduction of hidden VAT on cross-border intra-group supplies. CSAs were available in most (18) Member States until the 2017 CJEU judgement, but in the meantime have gradually been abolished for financial services providers, with VAT groups introduced as a substitute in countries where they were not previously available. At the time of writing, CSAs are still available in six Member States[450].

- **Rules for the proportional deduction of input VAT.** Since a single taxable person can and often does supply a mixture of taxed (and other supplies giving rise to a full right to deduct), exempt, and out-of-scope services, methods are needed to estimate the input VAT that can be deducted, i.e. the rules for a proportional deduction regime. Based on Article 168 of the VAT Directive, the VAT paid on inputs which are directly attributable to taxed or zero-rated transactions[451] can be deducted in full (known as 'direct attribution'). For inputs which are used both for taxed (including zero-rated) and exempt transactions ('mixed inputs'), the amount of deductible VAT can be calculated on methods described in Articles 173-175 of the VAT Directive: **direct** (or actual) use and pro rata f**or non-attributable input VAT** or a pro-rata **for all of the deductible input tax**. Under the actual use method, deductible VAT is calculated based on the real allocation of inputs between taxable and exempt supplies. Under the pro rata method, a ratio is used to estimate the proportion of taxed and zero-rated supplies over the total amount of supplies, which is then applied to the total deductible input VAT to calculate the proportion which can be deducted. Without taking into account the 'mandatory flat rate pro-rata calculation[452] in use in Italy (where it is mandatory for all taxable persons that provide exempt services habitually and Spain (as an option), three main 'families' of approaches can be distinguished:
    - **Pro rata**. The proportion of the VAT paid on goods or services used for both taxed and exempt transactions is determined by calculating the ratio of taxed turnover to the sum of taxed and exempt turnover. This is by far the most common approach, being in place in 18 Member States. In these Member States, the pro rata is the only available method, or the default method.
    - **Actual use**. To the extent possible, the inputs used for both taxed or zero-rated and exempt transactions must be attributed to taxed or exempt turnover, based on their use in the production process. VAT on inputs related to taxed turnover can be deducted in full. In four Member States, companies should apply the actual use method to the extent possible, and resort to pro rata only for the residual VAT. The application of this method is considered more complex by stakeholders, because it requires the use of a tailored IT system and the training of accounting personnel to identify and justify to the tax authority which inputs are attributable to taxed and zero-rated turnover[453].

[449] Most recently, the CJEU clarified the scope of the VAT cost-sharing exemption under Article 132(1)(f) of the VAT Directive in Judgment of the Court of 22 January 2026. *Agrupació de Neteja Sanitària, AIE and Educat Serveis Auxiliars SCCL v Tribunal Económico-Administrativo Regional de Cataluña (TEARC)*; Joined Cases C-379/24 and C-380/24; ECLI:EU:C:2026:29 Cf section 3.1.5 and 7.1.2

[450] Austria, Belgium, Finland, Italy, the Netherlands and Portugal.

[451] Such as 'exports' of financial services to non-EU customers.

[452] Under this system, the share of deductible input VAT on all inputs (taxed and exempt) is calculated based on a flat rate pro rata that is calculated on a yearly basis. The taxable person. calculates a general percentage of deductibility based on the ratio of the taxable and non-taxable supplies to the total turnover (taxable and exempt supplies). This means that the provider of financial services cannot directly deduct the input VAT paid on goods used for taxed transactions, but must apply the pro rata formula to the whole of its input costs. Cf Section 3.1.6.

[453] The actual use method is still normally complemented by a pro rata for input costs that cannot be attributed to specific outputs, such as on overheads.

- **Liberal**. In three Member States, the taxable person can use any of the standard methods or propose a different one, provided it can be reasonably justified to the tax authority and does not lead to an unfair (i.e. too favourable) deduction rate.

Box 13. Examples on the application of the rules for proportional deduction of input VAT

Actual use. The allocation based on the measured or demonstrable use of the input in taxable vs. exempt activities. So, for example, a firm uses a cloud software package for two activities: 60% for taxable data-analytics services and 40% for exempt payment-processing services. The invoice includes EUR 2,000 of VAT. Using the actual use method, deductible VAT would correspond to *EUR 1,200 (60% × EUR 2,000)*, and non-deductible VAT to EUR *800 (40% × EUR 2,000)*.

Pro-rata method. For instance, a financial institution provides both taxable investment-advisory services and VAT-exempt payment-processing services. During the year, the institution incurs EUR 1,000,000 of input VAT on a mixture of overheads—such as rent, utilities, IT systems and general administrative services—which cannot be directly attributed to one category of activity.

Its annual turnover is EUR 5 million from taxable and zero-rated services and EUR 15 million from exempt services, for a total turnover of EUR 20 million. The financial institution will then calculate a pro rata percentage based on the proportion of taxable turnover to total turnover:

$$\text{Pro rata} = \frac{€5m}{€20m} = 25\%$$

Since the purchased inputs are used for both taxed and exempt activities, these cannot be disentangled for the purpose of calculating the deduction based on the 'actual use' method. Instead, it applies the 25% pro rata to all input VAT incurred. Thus, the deductible input VAT will correspond to *EUR 250,000 (i.e., 25% × EUR 1,000,000*), while the non-deductible input VAT to *EUR 750,000*.

Flat rate pro-rata method: In the example above, the calculation is performed once a year and the out-of-scope transactions are also included in the calculation of the pro rata. The pro rata is based on the ratio of the taxable and non-taxable supplies to the total turnover (taxable and exempt supplies). The financial institution cannot deduct input VAT for taxed transactions and must apply the pro rata for all input VAT incurred.

9.2 Drivers

9.2.1 Driver 1 – Nature of the VAT exemption for financial services

The VAT system is designed as a broad-based tax on consumption applied to the widest possible share consumption of goods and services. Exemptions from these general rules depart from this logic (and hence must be applied strictly) for certain types of supplies, many of which are in the public interest e.g., medical care and social services. The EU VAT exemption on financial services dates back to 1977, largely reflecting similar provisions that already existed in Member States.

While the VAT Directive does not elaborate on the rationale for the exemption,[454] it is historically attributed to the practical difficulty of defining the tax base and applying VAT to services whose value-added is hard to measure or allocate. Taxing services based on interest rates poses particular challenges, since interest rates charged to customers on loans and related financial products build in both inflation and the risk of non-payment, while margins are not disclosed. While VAT could be more readily applied to services prices in fees and commissions, this would entail some risk of arbitrage if service providers structured products in certain ways to either be within or outside the scope of the exemption.

Aside from this core rationale, different grounds for the VAT exemption appear in the literature. These include the view that certain activities do not constitute consumption in the conventional VAT sense (for example, deposits), and that the exemption encourages their consumption by lowering their effective price.

[454] See the 2007 IA, in addition to the European Parliament, Report on the proposal for a Council directive amending Directive 2006/112/EC on the common system of value added tax, as regards the treatment of financial and insurance services (COM(2007)747) – C6-0473/2007, 15 September 2008, and also VAT Expert Group, Update on the state of play of financial and insurance services and their VAT treatment, VEG N° 082, 15 March 2019 and VEG N° 089.

It should also be noted that, given the exemption's long history, path dependency also plays an important role, since it has become embedded in the status quo. Shifting to an alternative system could entail complex, uncertain and potentially costly adjustments for both providers and consumers as well as administrations.

However, the rationale for the VAT exemption has become less compelling over time, particularly as technological and regulatory developments (see Driver 2 and Driver 3 below) have made it more feasible to define and practically identify the tax base, and to build the taxation of financial services into the VAT system. Reflecting this evolution, jurisdictions outside the EU have increasingly moved toward taxing a broader range of financial services. These are summarised in Box 14 below and further analysed in Section 3.2.

Box 14. Third-country approaches to VAT / Goods and Services Tax (GST) in the financial sector'

Different methods are applied around the globe for the taxation of financial services. Countries in the EU's immediate orbit (United Kingdom, Switzerland and Norway) apply exemption frameworks similar to the EU, though with some distinctions that may meaningfully alter the situation for providers of financial services.

For example, departing from a previously strict approach, since 2025 the UK has allowed non-UK establishments of UK businesses can be included within a UK VAT group, which in principle would give UK financial service providers greater scope to reduce hidden VAT than in the EU[455]. However, this treatment is subject to anti-avoidance provisions, and the actual impact on VAT liabilities has not been assessed for the purposes of this study. In addition, UK establishments of non-UK entities may be included in a UK VAT group provided that the conditions for VAT grouping are met.

Other countries tend to apply different approaches. These can be divided into (i) selective taxation of fee-based activities, (ii) partial taxation supplemented by sector-specific deduction mechanisms, and (iii) full taxation with comprehensive input VAT recovery.

In relation to the UK, it should be stressed that a more liberal approach to the structural provision of VAT groups is followed. Based on the Skandia and Danske Bank cases[456] supplies from foreign branches to VAT groups are taxable. In contrast, the UK recently confirmed that it does not follow the interpretation, meaning that providers of financial services based in the UK can reduce VAT for intra-group supplies made cross-border[457]. The UKVAT rules thus allow cross-border intra-group supplies to be free of VAT with greater flexibility than in the EU. This lowers the effective cost of operating group structures in the UK.

Japan and Mexico apply VAT selectively to financial services, taxing only certain fee-based activities while exempting core financial transactions like loans, securities trading, and insurance. Japan's 10% consumption tax applies to explicit-fee services such as money transfers, underwriting, and advisory activities, while exempting traditional monetary and securities transactions. Mexico similarly exempts most financial operations but taxes fee-based services like financial advisory and credit card fees at 16%. Both countries use pro rata rules to determine deductible input VAT, depending on the mix of taxable and exempt activities.

A second group of countries—including New Zealand, Singapore, India, Australia, and South Africa—also taxes certain fee-based financial services but introduces sector-specific deduction mechanisms to reduce hidden VAT costs. New Zealand allows zero-rating for most B2B supplies of financial services and offers flexible deduction rules via sectoral agreements. Singapore applies 9% GST to intermediation and advisory services and uses fixed input tax recovery rates or special deduction methods for banks. India taxes fee-based financial services at 18%, but institutions may only claim 50% of input tax credit on mixed inputs. Australia uses "reduced input tax credits" to partially refund VAT on specified services, while South Africa taxes fee-based transactions at 15%.

Finally, China and Brazil stand out for fully taxing financial services, including interest income, while allowing full input VAT recovery. China applies a 6% VAT on all financial supplies, whereas Brazil's reform is gradually introducing

[455] Still, this treatment is subject to anti-avoidance rules, and the impact on VAT liabilities has not been assessed for this study. In addition, UK establishments of non-UK entities may be included in a UK VAT group provided that the conditions for VAT grouping are met, cf. Barclays Services Corporation & Barclays Execution Services Ltd v The Commissioners for His Majesty's Revenue and Customs, (2026) UKUT 211 (TCC) (U.K. Upper Tribunal (Tax and Chancery Chamber)).

[456] Judgment of the Court of 17 September 2014, *Skandia America Corp. (USA), filial Sverige v Skatteverket*, Case C-7/13, ECLI:EU:C:2014:2225. and Judgment of the Court of 11 March 2021, *Danske Bank A/S, Danmark, Sverige Filial v Skatteverket*, Case C-812/19, ECLI:EU:C:2021:196., respectively.

[457] HMRC, Revised VAT grouping rules and the Skandia judgment, Published 26 November 2025.

a dual system taxing fee-based services under standard VAT and margin-based services under a subtraction-based method—both enabling full deduction to improve neutrality and reduce cascading taxation[458].

Within the EU, the implementation of the exemption is largely consistent but also differs in certain respects due to its complexity and need for interpretation at national level. The legal framework relies on detailed categorisation of exempt and taxable activities, supported by a combination of the provisions of the VAT Directive, implementing measures and extensive jurisprudence. As mentioned above, Article 135(1)(a)-(g) of the VAT Directive lists the exempted activities, without providing further details on the exact scope of the services covered by the exemption.[459] As a consequence, the exemptions have been interpreted by the CJEU in a large number of judgements, the bulk of which is related to the definition of whether certain transactions have to be considered as an exempt financial service, or a constituent element thereof. As a general interpretation applicable to the whole VAT Directive, the exemptions are *lex specialis* compared to the general VAT exemption framework and must thus be interpreted narrowly.[460]

Box 15. Member States' interpretation of the definition of financial services

Member States interpret the Directive's definition of financial services shaping the scope of the VAT exemption. Broader national definitions exempt more services, while narrower definitions render more services taxable. The study focused on services where interpretation is most problematic or litigated: insurance-related services, derivatives, payment services, fund/asset management, fintech and crypto activities (see section 8.1.2).

Overall, implementation is largely uniform, however, key divergences persist mainly in insurance-related services, and in the treatment of certain investment and services related to pension funds, affecting associated asset-management services. Despite these differences, stakeholders report limited competitive distortions; their main concern is legal uncertainty rather than tax burdens. Perceived competitive issues for fintechs stem not from their status as suppliers but from the fact that they typically provide supporting services that fall outside the exemption.

Across sectors, CJEU case law shapes the boundaries: insurance exemptions remain narrowly interpreted; only payment services directly involving fund transfers are exempt; fund management exemptions depend on UCITS equivalence and state supervision; and asset-management exemptions apply only when services are specific and essential to collective investment. Innovative services—including fintech and crypto-asset activities—are assessed case by case, based on whether they constitute financial transactions under Article 135. Most crypto-related exchanges are treated as exempt (similar to currency transactions), whereas custody, support and DeFi-related services often fall outside the exemption and are taxable.

Aside from the definitions, another immediate effect of the exemption has been to **necessitate the array of structural provisions described above to implement it** effectively and minimise the negative consequences for businesses, particularly in terms of hidden VAT. The application of the structural provisions differs widely across Member States. VAT groups are in the widest use, being currently available in 21 Member States[461]. The number has been growing in recent years, as countries have introduced VAT groups as a substitute for CSAs. The latter are being phased out following the above-mentioned CJEU judgement and are currently available to providers of financial services in just six Member States[462], down from a peak of 18.

[458] Since January 2026, a test phase has applied a combined 1% rate (0.9% CBS and 0.1% IBS) on both fee-based and margin-based transactions. Amounts collected during this period can be offset against PIS/COFINS liabilities, provided taxpayers correctly adapt their ERP and reporting systems.

[459] Based on Article 397, the Directive is implemented, in relation to certain transactions, by a Council Implementing Regulation, dealing only to a very limited extent with financial and insurance services. Specifically, it specifies that: (i) transactions in nobles from the Isle of Man must not benefit from the exemption though they are legal tender therein (Article 45); and (ii) the sale of an option, where such a sale is considered a transaction in securities covered by Article 135(1)(f), must be considered a supply of services, distinct from the underlying transaction to which the option refers. Cf. Council Implementing Regulation (EU) No 282/2011 of 15 March 2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax.

[460] Cf. *i.a.* Stichting Centraal Begeleidingsorgaan voor de Intercollegiale Toetsing, C-407/07, EU:C:2008:713, at § 30, and the jurisprudence mentioned therein.

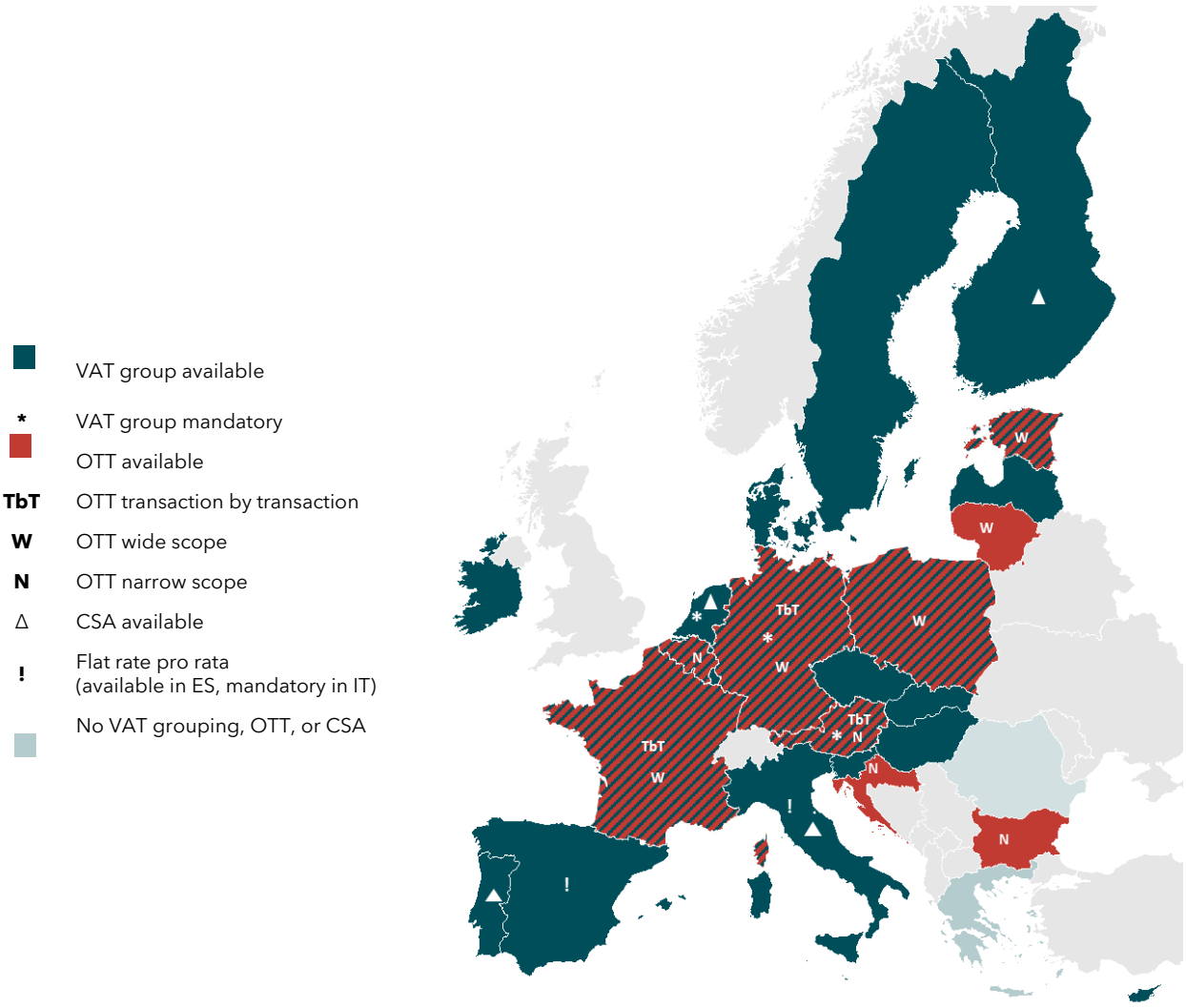
[461] VAT Groups are not in place in Greece, Croatia, Lithuania and Romania. Slovenia introduced VAT groups in 2026.

[462] Austria, Belgium, Finland, Italy, the Netherlands and Portugal.

Only nine Member States[463] make use of the option to tax for the provision of financial services. In line with Article 137(2), Member States are free to determine the conditions governing the exercise of the option, e.g., wide or narrow scope, comprehensive vs transactional application. Section 3.1 provides more detail on the differences which in practice enhance the discrepancies across Member States, as national regulations and the specific conditions governing its use influence the use of the option.

Finally, as for proportional deduction rules, all Member States use the direct attribution method but 2 Member States[464] which provide in their legal framework for a flat rate pro rata system. For mixed inputs, pro rata is the most widespread method applied but there are many variations and nuances across Member States.

Figure 73. Overview of structural provisions



Source: Authors' elaboration based on the 2025 legal mapping

[463] Austria, Belgium, Bulgaria, Croatia, Estonia, France, Germany, Lithuania, and Poland.

[464] Italy and Spain.

9.2.2 Driver 2 – Emergence of a patchwork of national taxes partly aimed at offsetting the VAT exemption

Outside the VAT framework, Member States apply a variety of sectoral taxes[465]. A comprehensive mapping and assessment[466] conducted for the study serves to highlight the fragmented and diverse nature of financial taxation in the EU. More specifically, the assessment identified 92 national measures, across six distinct categories of tax:

1. **Taxes on the sale of certain products** (e.g., insurance premium taxes (IPTs) and certain stamp duties)[467];
2. **Financial transaction taxes** (FTTs);
3. **Financial institution levies**, which encompass different types of additional taxation measures for financial institutions, such as bank levies that were introduced in the aftermath of the 2007-09 financial crisis;
4. **Payroll taxes**, referring to additional taxes on staff salaries[468];
5. **Additional Corporate Income Tax** (CIT) levied specifically on financial institutions;
6. So-called **windfall taxes**, targeting additional profits occurring in the financial sector due to unforeseen circumstances.

The majority of identified tax measures are taxes on transactions, among which the Insurance Premium Tax (IPT) is the most widespread, being used in 21 Member States[469]. Almost one-third are financial institution levies, while payroll taxes, financial transaction taxes (FTT), additional CIT, and windfall taxes are only imposed in a limited number of Member States. In terms of revenue generation, taxes on supplies of financial products contribute over two-thirds of the total of ca EUR 82 billion, amounting to over EUR 63 billion in 2023 – equivalent to about 9% of the EU GVA for financial activities. Financial institution levies account for EUR 7 billion (1% of EU GVA), while the other types of tax measures all account for less than 1% of GVA, respectively. The list also includes a small number of taxes that had not yet become payable in the reference year. Overall, the revenue collected represents about 12% of the GVA of the financial sector in the EU, with major variations between countries ranging from zero to upwards of 30% in France and Hungary, and close to 2% of total tax receipts in the EU. Moreover, the **fragmentation of tax measures targeting the financial sector has further increased in recent years**, not least with the rise of windfall taxes (on extraordinary profits) as a new type of tax. In total, 15 new taxes have been introduced in the last

[465] Article 401 of the VAT Directive allows Member States to maintain or introduce taxes on insurance contracts, stamp duties or, more generally, any taxes, duties or charges which cannot be characterised as turnover taxes. This is provided, under the condition that collecting those taxes, duties or charges does not give rise, in trade between Member States, to formalities connected with the crossing of frontiers. Moreover, according to Article 6 of the Capital Duty Directive, Member States may not levy indirect tax on the raising of capital but can charge certain transfer duties, fees, dues or value added tax.

[466] The assessment focused on taxes targeting financial services or providers of such services explicitly, with the relevance of each tax determined based on three conditions, namely (i) its rationale, such as whether the tax compensates for the VAT exemption (e.g., insurance premium taxes or payroll taxes); (ii) its tax base, determining if it operates as an ad valorem sales tax on relevant products (e.g., financial transaction taxes or insurance premium taxes); and (iii) whether it is a sector-specific levy, predominantly applied to e.g. banks or insurance companies. General taxes and those affecting individuals are excluded.

[467] In addition, four Member States (Greece, Spain, Poland and Portugal) continue to levy indirect taxes on the raising of capital under the standstill clause of the Capital Duty Directive (Council Directive 2008/7/EC). While the Directive generally prohibits taxes on the raising of capital (such as capital duty on company formation or capital increases) the standstill clause permits Member States that applied such duties on 1 January 2006 to maintain them, subject to strict conditions.

[468] For example, in France article 231 of the General Tax Code applies the tax using as a tax base salaries and benefits in kind paid to staff.

[469] Austria, Belgium, Bulgaria, Cyprus, Germany, Denmark, Spain, Finland, France, Croatia, Hungary, Ireland, Italia, Luxembourg, Malta, the Netherlands, Portugal, Sweden, Slovenia, Slovakia.

five years. Table 40 below provides an overview of the 92 taxes by category, showing how frequently they occur and the revenues generated in 2023 (when this was available, as was the case for 80 of the taxes).

Table 40. National tax measures by category

Type of tax	No. of Member States with tax in force	No. of taxes identified	No. of taxes with revenue data for 2023 available	Total tax revenue 2023				
				EUR billion	% of total tax revenue	% of GVA of financial indutry[470]	% of GVA of sub-sector[471]	% of GDP
Taxes on the sale of financial and insurance products	21	49	45	63	1.4%	8.9%	-	0.4%
… of which IPT or equivalent	21	40	36	54	1.2%	7.6%	*Insurance* 46%[472]	0.3%
Financial institution levies	14	22	20	7	0.2%	1.0%	*Banks* 1.4%	0.0%
Payroll taxes	2	2	2	6	0.1%	0.8%	-	0.0%
Financial transaction taxes	7	7	6	3	0.1%	0.5%	-	0.0%
Additional CIT	5	5	2	0.5	0.0%	0.1%	-	0.0%
Windfall taxes	7	7	5	2.6	0.1%	0.4%	*Banks* 0.6%	0.0%
Total		**92**	**80**	**82**	**1.8%**	**11.6%**		**0.5%**

Source: Taxes in Europe Database, Eurostat National Tax Lists, Targeted Consultation, and the previous study

9.2.3 Driver 3 – Evolving business models and practices that rely increasingly on outsourcing and specialisation

Conceptually, most types of financial services have remained broadly consistent over time, in that banks provide a wide range of services as financial intermediaries, including the granting of credit, the insurance industry provides risk management, and investment services involve the management of assets and funds. However, the ways in which these services are produced and delivered has evolved profoundly in recent decades. In particular two main factors can be observed:

- the impact of digitalisation on business models and supply chains
- the regulatory and organisational developments influencing how services are structured

[470] GVA data from Eurostat, National Accounts, covering financial and insurance activities (Codes 64, 65, and 66).

[471] Some taxes apply exclusively or mostly to specific financial institutions. Hence, a more focused comparison is made with respect to: IPT (GVA of the insurance industry); Financial institution levies and windfall taxes (GVA of banking).

[472] The high percentage reflects the way insurance output is measured in national accounts. GVA for the insurance sector is not based on the full value of premiums written, but rather on the service margin – that is, broadly the difference between premiums received and claims paid, plus investment income. As a result, insurance GVA is substantially lower than total premium income, which forms the tax base for IPTs. The ratio of IPT revenues to insurance GVA therefore appears disproportionately high and should be interpreted accordingly.

Together, these factors have influenced value chains, increased reliance on technology and specialised inputs, and intensified the relevance of VAT costs for financial services providers.

Digitalisation has been the main driver of transformation. Modern financial services providers are increasingly dependent on IT systems that support product development, risk assessment, customer interfaces and internal operations. These systems have contributed to the growth of the fintech sector. Fintech encompasses a variety of categories and subcategories of financial services. Their business models vary widely, and they operate across different traditional segments.

The first segment includes **payment and digital banking providers**, who offer web- and app-based services such as deposits, wire transfers, card-based payments, e-money accounts, point-of-sale technologies and remittance solutions. A closely related area is the fast-growing field of **embedded finance**, where financial services such as payments, lending and insurance are integrated directly into non-financial platforms via Application Programme Interfaces (APIs), enabling financial functions to 'disappear' into everyday digital experiences.

Another segment includes insurance related technologies or **'Insurtech'**. 'Insurtech' encompasses technology-driven insurance and solution providers offering advanced analytics, personalised and on-demand insurance products, and internet-of-things tools for data collection, claims prevention and claims management. All these developments are supported by a broader layer of enabling technologies, including AI-based predictive analytics, tools for investment research and credit scoring, and open-banking infrastructure that allows third parties to build financial products on top of regulated institutions' data and systems.

Investment-related fintech forms another significant cluster. Robo-advisers use algorithms to provide automated portfolio recommendations, while low-cost trading apps enable individuals to manage their own investments more easily than through traditional intermediaries. Many of these platforms rely heavily on artificial intelligence, which is now pervasive across the fintech sector more generally.

Other fintech models focus on the pooling of capital from dispersed users. Crowdfunding platforms offer entrepreneurs access to funding—whether through donations, equity or loans—via web-based or mobile interfaces that connect them directly with large groups of potential backers. Meanwhile, the emergence of crypto-asset service providers has created a distinct ecosystem offering custody, exchange, order-execution and trading-platform services for digital assets, as well as the facilitation of transactions between crypto-assets and fiat currencies.

Finally, regulatory technology—or '**RegTech'—**has become an important category in its own right. By leveraging big data, AI, machine learning and deep learning, RegTech firms provide automated, real-time tools that help financial institutions meet compliance and reporting obligations and manage risk more effectively.

To stay competitive, providers of financial services have to swiftly adopt new technologies in their organisations and are indeed among the main consumers of those services[473]. Research in the banking sector[474] indicates that banks are directing their technology investments towards specific, high-impact areas that align with digital transformation objectives. Banking as a Service (BaaS) has emerged as a key investment priority, with **39% of institutions worldwide having developed BaaS capabilities within their organisations**. On average, banks in the EU spend 2.8% of their budget on digital transformation.

The **largest financial conglomerates have built large internal IT departments** which provide IT services and equipment throughout their groups. Decisions to make the investments needed to internalise such services are essentially driven by business decisions, but also by an incentive to minimise the VAT incurred on outsourced services, much of which cannot be deducted. Nonetheless, to varying extents (depending on e.g. whether they have the relevant knowledge or the scale required to justify making these in-house

[473] European Commission (2018), FinTech Action plan: For a more competitive and innovative European financial sector, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018DC0109&from=EN.

[474] Finastra, Financial Services State of the Nation 2024 (February 2025), available at state-of-the-nation-report-2024.pdf

investments) businesses rely on external service providers and external IT experts for the application of new technologies.

Value chains in the financial sector have been reshaped by a broader organisational trend: companies have increased focus on their core activities, while turning to specialised suppliers for inputs. In other words, the pendulum between 'make' or 'buy', i.e. whether to produce an intermediate output within a company or purchase it on the market, has moved to 'buy'. By providing the same inputs to multiple players, specialised suppliers can be more efficient, achieving economies of scale, scope, and learning, which in turn spurs innovation. In the financial services sector, this centralisation of input supplies has taken two forms: '**groupsourcing'**, when a single entity within a corporate group provides specialised inputs (e.g. providing IT services, accounting, tax) to all parts of the group; and **outsourcing**, when the provision of those support services is externalised to a third party.

As put by one banking stakeholder taking part in the targeted consultation, and echoed by many others, 'banks and insurance companies are becoming IT companies that provide financial and insurance services'. This means that, while IT has become more specialised and important across the board, for the financial sector the phenomenon is even more pronounced[475] and represents an increasing VAT burden as the input VAT paid for outsourced IT services is non-deductible for financial operators providing exempted financial services. The rise of fintech services has forced the CJEU to clarify the VAT boundary repeatedly[476], emphasising that innovations integral to an exempt service may remain exempt, while standalone technical solutions are typically taxed. Yet, as long as the VAT Directive remains outdated in relation to the definitions (see Problem 2 below), the CJEU jurisprudence will guide the boundaries of the exemption.

Globalisation adds another layer of complexity and competitive disadvantages for the EU financial sector. Financial services markets were almost exclusively domestic until the 1970s, due to technological, regulatory and other barriers. Afterwards, both EU intervention and wider globalisation led to the **creation of multinational EU-wide financial conglomerates.** Although most financial services are still provided by domestic players, multinational conglomerates operate in some Member States such as Luxembourg and Ireland and are predominant in certain sectors (e.g. retail banking in the Baltic Member States). Due to supervisory and regulatory requirements as well as business reasons, in most cases those groups operate through domestic local subsidiaries, not branches. Since services provided between subsidiaries in the same group are typically taxed, this exacerbates the potential impact of intra-group input VAT. This can be limited by the application of VAT grouping (Article 11) where permitted, but only to a certain extent, with an important limitation being that VAT groups can only operate domestically. At the same time, conditions may differ in third-country jurisdictions, such as the UK which, as mentioned above, allows non-UK entities to be included in UK VAT groups, thereby conferring a potential tax advantage by making cross-border intra-group supplies outside the scope of VAT.

Finally, **sectoral regulation has also affected value chains and the services provided,** fostering or leading to new services which were not contemplated when the VAT Directive was designed. A few examples serve to illustrate this. Both the Markets in Financial Instruments Directive (MiFID)[477] and the Insurance Distribution Directive (IDD)[478] strengthened the role of intermediaries as independent advisors, creating problems about whether and under which conditions independent investment or insurance advisory services should be construed as exempt services, or taxed services of providing advice.

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[475] Cf Chapter 4 *cf also* European Central Bank (2025), Outsourcing trends in the banking sector "Overall, the 2024 analysis shows that banks were increasingly relying on outsourcing. Year-end data for 2023 indicate that the share of administrative expenses spent on all outsourcing services from external providers has increased from 6.8% to 7.2%. Outsourcing of ICT services, especially cloud services, continued to grow.

[476] Indeed, the role of jurisprudence in guiding the boundaries of the exemption is set to continue as long as the definitions in the VAT Directive itself remain outdated, as discussed further under Problem 2 (see 9.3.2).

[477] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast) (Text with EEA relevance)

[478] Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast)Text with EEA relevance.

Historically, for companies largely producing services in-house and providing exempt services, hidden input VAT might have been addressed as a minimal point of attention. Presently, in an environment with exponentially more specialist service providers, where even the largest conglomerates outsource substantial parts of their value chain and incur significant IT systems costs, 'hidden VAT' forms a more important cost[479].

9.3 Problems

9.3.1 Problem 1 – Tax-driven distortions in the production and supply of financial services

As mentioned above, the fractionated payment mechanism of the VAT system normally ensures value chain neutrality. In other words, the tax position of a company should not depend on how it arranges its production process, in terms of e.g. the number of intermediate transactions and whether inputs are produced internally or sourced from external providers. As long as all input VAT is deducted, and output VAT charged to customers, the only element that matters from a fiscal perspective is the tax base at the last stage.

In contrast, the VAT exemption for supplies of financial services breaks VAT neutrality by taxing intermediate rather than end consumption. This increases the cost of purchasing input supplies, and is thereby distortive, creating a risk of interference with the business models and structures of financial services providers. The seriousness of the distortion depends on the extent to which it materialises in practice and in which types of situations. After all, if the financial services sector was dominated by full-service firms (i.e. providing mostly services subject to VAT or giving rise to a right to deduct) or firms producing the vast majority of services in-house, the problem would be largely theoretical.

In fact, the analysis done for the study finds that **the distortions are serious in practice and progressively becoming worse because of the evolving business dynamics** described in Driver 3 above. Namely, the pendulum between 'make' or 'buy', i.e. whether to produce an intermediate output within a company or purchase it on the market, has moved to 'buy'. By providing the same inputs to multiple players, specialised suppliers can be more efficient, achieving economies of scale, scope, and learning, which in turn spurs innovation.

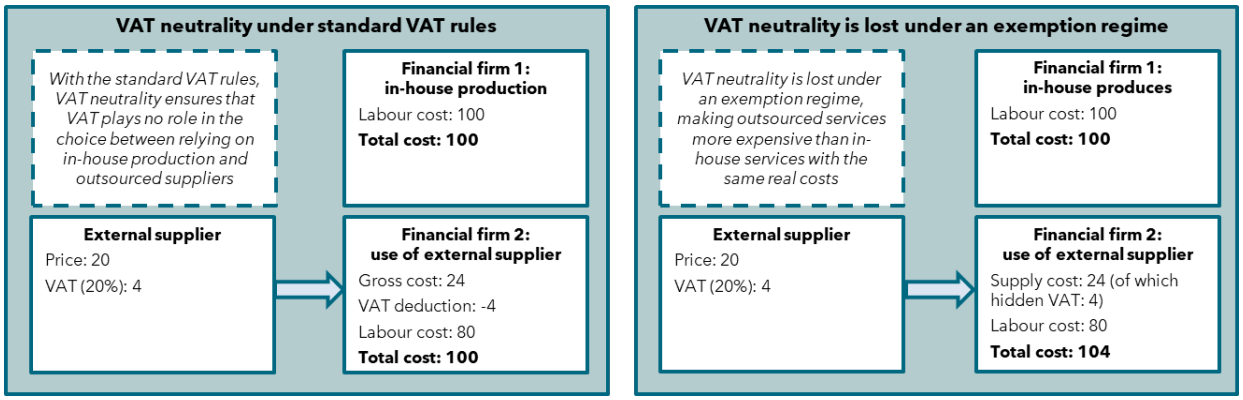
Linked to this, in the financial industry, this centralisation of input supplies has taken two forms: '**groupsourcing'**, when a single entity within a corporate group provides specialised inputs (e.g. providing IT services, accounting, tax) to all parts of the group; and **outsourcing**, when the provision of those support services is externalised to a third party.

This is coupled with the **growing importance of IT systems for the financial sector**. IT services, as well as all non-financial support services, are subject to standard rate VAT. Because of the exemption, providers of financial services will only deduct part of the VAT incurred on those services (i.e., the portion used to make taxable supplies, bearing in mind differences in proportional deduction rules). Hence, compared to industries subject to the standard VAT treatment, **purchasing services from an external supplier, either within or outside a corporate group, is more costly because of the VAT exemption.** More precisely, the additional tax burden, in the form of hidden VAT, amounts to the standard VAT rate weighted by the share of non-deductible VAT. The issue is especially acute for smaller service providers of financial services, both because they are less readily able than large corporate groups to produce inputs in-house, and because their supplies often serve as inputs for other firms in the sector.

The mechanism is illustrated in the figure below.

[479] Cf Chapter 5 on VAT liability and compliance analysis.

Figure 74. The impact of the VAT exemption on neutrality in the value chain



Source: Authors' elaboration

In the EU, there is no provision explicitly aimed at reducing this tax burden with respect to outsourcing. In other jurisdictions, this aspect is addressed by either allowing for a (high) fixed deduction rate, e.g., up to 70% in Australia, or by favourable non-legislative agreements on the deduction rules for the banking industry, as in Singapore. In addition, in countries in which the scope of the exemption is narrower (e.g. Japan, or, more significantly so, New Zealand), the higher share of taxable output, often combined with lower standard VAT rates, makes the additional cost of outsourcing lower.

When it comes to groupsourcing, **two partial solutions have existed, namely VAT groups[480] and CSAs[481] (the latter being phased out).** VAT groups eliminate all intra-group VAT, thus allowing the centralisation of input supplies at group level; this can significantly increase the efficiency of centralisation, especially for large groups. However, the scope of VAT groups is strictly national, which means that multinational groups bear input VAT on supplies between the centralised input supplier and their foreign entities[482]. The requirement for strong financial and organisational links means that VAT groups are also not available, in some countries[483], for cooperative banks. CSAs would eliminate intra-group VAT also in the case of looser group links, as well as, with some limitations, for multinational groups. However, following the 2017 CJEU cases, they have been eliminated in most EU Member States, which make their cross-border usage practically impossible. Their definitive phasing-out would further reduce the tools for financial institutions to reduce non-deductible intra-EU VAT; however, with the progressive introduction of VAT grouping, the relevance of CSAs is becoming more and more limited, and, in certain cases, they are more often used for administrative or organisational reason, having been incorporated into VAT groups.

The targeted consultation served to confirm the above analysis, with providers of financial services taking part unanimously agreeing that the **VAT exemption increases the cost of outsourcing or groupsourcing due to the reduced ability to deduct input VAT.** This makes outsourced or groupsourced services more expensive, particularly in areas such as IT, financial business services, and claims handling. As a result, businesses are incentivised to keep services in-house or within their corporate group (where VAT group is available) to avoid additional VAT costs.

While it was only possible to examine this empirically to a limited extent (see Box 16 below), the results tentatively suggest that financial services providers are **more likely to outsource services in situations where they do not incur VAT** compared to similar situations where these supplies are taxed.

[480] Article 11 Directive 2006/11/EC.

[481] Article 132 1(f) Directive 2006/11/EC.

[482] Based on the *Skandia* and *Danske Bank* cases (C-7/13, EU:C:2014:2225 and C-812/19,ECLI:EU:C:2021:196, respectively), supplies from foreign branches to VAT groups are taxable. In contrast, the UK recently confirmed that it does not follow this interpretation, meaning that providers of financial services based in the UK can reduce VAT for intra-group supplies made cross-border, cf. HMRC, Revised VAT grouping rules and the Skandia judgment, Published 26 November 2025.

[483] E.g. Austria.

A few companies and business federations provided more detail, highlighting that **the financial burden associated with outsourcing under the VAT exemption partly discourages them from outsourcing, even when this would be the more efficient business decision**. Instead, companies devote significant energy to structuring their operations in a way that brings as much as possible of the value chain in-house or within a VAT group, thus minimising the financial impact of non-recoverable VAT. That said, most businesses consulted reported that in cases where outsourcing or groupsourcing is unavoidable, they simply accept the additional VAT cost, at some reduction in efficiency compared to a scenario where the exemption did not exist.

Box 16. Impact of the VAT exemption on the outsourcing of asset management services

As discussed in problem 2 below, the VAT treatment of asset management services differs by country, such that, if supplied to another financial institution, these are taxed in some Member States and not in others. This creates the conditions for a comparison between the behaviour in different countries with regard to outsourcing decisions. Specifically, it would stand to reason that in countries where the exemption for asset management services is broader, companies in the financial sector (i.e., sellers of mainly exempt supplies) should outsource asset management services to a greater extent than countries with a narrower interpretation. This was examined by looking at the share of supplies from other financial services (NACE 66) to customers in the banking and insurance industries (NACE 64 and 65) across fieldwork countries. The results of the quantitative analysis are briefly described in the text and table below, though the limited number of observations means the analysis is not statistically significant and must be interpreted with caution.

The results of the analysis are mixed depending on the sector examined. For insurance companies, a broader application of the VAT exemption positively influences the tendency to use external asset managers, meaning that **a greater share of services is outsourced in Member States in which those services are considered exempt and hence insurance companies are not burdened with hidden input VAT**. The fact that insurance companies make nearly exclusively exempt supplies reinforces this trend. In contrast, the analysis shows that banks do not outsource more asset management in countries with a broader interpretation of the exemption. Though the reason could not be determined from the data, a potential explanation is that the banking sector (in comparison with insurance) is more likely to offer asset management services as part of their portfolio, and hence to handle such tasks in-house regardless of their VAT treatment.

Outsourcing of asset management services in countries with different VAT treatment

	Asset management services (CPA 66) in total intermediate use		
Local treatment of asset management services	**Banking**	**Insurance**	**Other financial services**
Exempt	13%	52%	45%
Exempt under special circumstances	16%	34%	12%
Not exempt	21%	32%	34%

Source: Authors' elaboration based on VAT analysis

9.3.2 Problem 2 – Uncertain, complex and fragmented VAT and sectoral tax framework

Applying the VAT exemption to the quickly evolving and multifaceted financial sector necessarily requires a complex and shifting framework to keep track of which services do and do not benefit from the exemption and to allow for appropriate deductions of input VAT. Compared to a standard VAT system, this inevitably generates a degree of legal uncertainty and complexity, which is exacerbated by discrepancies between Member States. The sectoral taxes applied to the financial sector, while not generally difficult to administer per se, have the effect of contributing to the problem due to their sheer number, complex interactions with the VAT framework and fragmentation across Member States. The problem is discussed in more detail below, in terms of the structural definitions and service definitions used to implement the VAT exemption, respectively, then in terms of sectoral taxes.

➢ *Structural provisions of the VAT exemption for financial services*

As discussed under Driver 1, several structural provisions are used to support the application of the VAT exemption, namely the option to tax, VAT groups, Cost-Sharing Arrangements (CSAs), and rules for

deduction. Their varied application is itself a major source of legal uncertainty and regulatory complexity. Irrespective of the sectoral regulatory framework, financial service providers whose supply chains and operations span multiple Member States must take account of the applicable VAT provisions not only in their Member State of establishment, but in other jurisdictions where they have operations. This adds a significant layer of regulatory complexity, acting as a barrier to cross-border trade and reinforcing the domestic nature of the markets for most financial services. There are also more specific sources of legal uncertainty and regulatory complexity that relate to the features and implementation modalities of the different structural provisions. These are discussed below starting with the proportional deduction rules, since they are by far the greatest source of uncertainty concerning the VAT exemption.

Rules for proportional deduction. The rules for proportional deduction are of utmost importance to providers of financial services and tax authorities, since, with most output being exempt, it is the key determinant of VAT liability. As a general rule, providers of financial services (i) can deduct the VAT incurred on taxed / zero-rated transactions, which typically represent a small minority; (ii) can *partly* deduct the VAT incurred on mixed inputs (i.e., inputs that are used to supply both exempt and taxed / zero-rated services); and (iii) cannot deduct the VAT associated with exempt transactions, which typically represent the majority. While conceptually straightforward, applying these principles in practice is highly complex, a fact that is exacerbated by the diversity of appoaches taken across Member States.

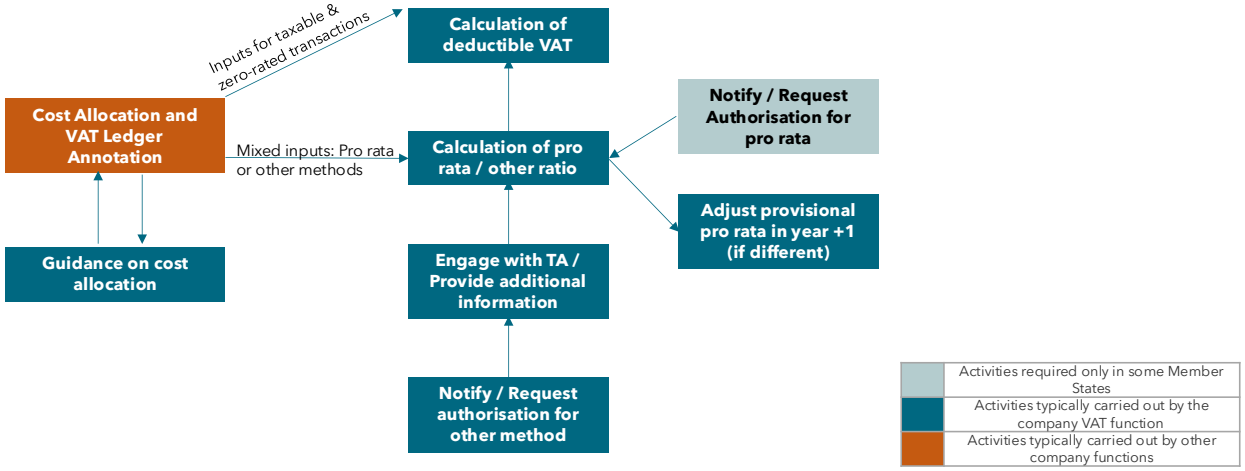
Most of the diversity and complexity concerns the method for calculating partial deductions from mixed inputs[484]. While the 'pro rata' is the most widespread method, in fact there are many variations and nuances across Member States, which under the discretion of tax authorities can be required (in general or under specific circumstances), allowed by (with or without notification to or authorisation by the tax authority), accepted in practice, residual (when other methods cannot be used satisfactorily) or prohibited. As noted above, the Member States fall into roughly three 'families' of approaches, namely pro rata, actual use and liberal, in addition to the flat rate pro rata in use in Italy and Spain.

Compliance with any of the approaches aside from the general pro rata require a **series of complex activities**. The work starts with the allocation of input costs to the various outputs, and in particular distinguishing between inputs which are directly attributed to taxed and zero-rated transactions, mixed inputs where the actual use is identified for those transactions, and other mixed inputs which cannot be attributed and which go into the pro rata. Once the input allocation is completed, the VAT function within the organisation calculates the deductible VAT based on direct attribution and actual use (in the Member States in which these are available), and the ratio resulting from applying the pro rata, the sectoral pro rata, or any other method.

In some Member States, the tax authorities have to be notified of or authorise in advance the use of the pro rata(s). If the company intends to use a special method, it must notify or request an authorisation from the tax authorities, and, if so required, engage with the tax authority to provide information and a reasonable justification for the method used. Dealing with the proportional deduction rules also involves a degree of **legal uncertainty, due to the scope for interpretation about how tax authorities implement the rules** concerning deduction methods to be used and calculations applied.

[484] For taxed inputs, 25 of 27 Member States use the 'direct attribution' method. Italy and Spain are the exceptions and apply a general pro rata whereby the share of deductible input VAT on all inputs (taxed and exempt) is calculated based on a pro rata, i.e., on the share of taxable transactions over taxable and exempt transactions, in line with the provisions of Articles 174 and 175 of the VAT Directive. This means that the provider of financial services cannot directly deduct the input VAT paid on goods used for taxed transactions, but must apply the pro rata formula to the whole of its input costs.

Figure 75. Activities required to comply with the proportional deduction rules



Source: Authors' elaboration
Notes: in blue, activities typically carried out by the company VAT function; in light blue, activities required only in some Member States; in orange, activities typically carried out by other company functions. TA = tax authority

Option to tax (available in nine Member States[485]). Under the option to tax, suppliers of financial services (but not insurance) operators[486] can opt to charge VAT on certain or all of their services, and thus increase the share of taxed turnover and the corresponding input tax deductions. Member States take approaches that differ according to whether the option is available widely (five Member States) or only for a narrow set of services (four Member States); and once taken, must be applied to all transactions of a given type (six Member States), or can be applied on a transaction-by-transaction basis (three Member States). National approaches also differ in terms of whether / how companies need to notify the tax authorities of their intention to use the option, duration (with some countries requiring a minimum time period once making use of the option) and how companies should determine the taxable basis for certain transactions (particularly the granting of credit).

The **use of the option to tax varies significantly**, influenced by both national regulations and the specific conditions governing its use. According to the legal mapping and consultation findings, Germany and Belgium are the countries where this option is more widely utilised, whereas its adoption appears to be moderate in France (though use is likely to grow since the option was only recently made more flexible) and Croatia. In the other five Member States[487], either the option is not commonly used or there is limited information available on its implementation. Complexity has been described by stakeholders as a barrier to the wider uptake of the option since, despite its advantages, it involves certain initial administrative and IT costs, to identify the transactions that can be subject to VAT, adjust internal IT systems and train t personnel accordingly.

VAT Groups (available in 22 Member States[488]). As mentioned, VAT groups have been increasing in prominence alongside the gradual abolition of CSAs (discussed below) where they had previously been available. Where VAT Groups are available, approaches differ in three main ways:

[485] Austria, Belgium, Bulgaria, Germany, Estonia, France, Croatia, Lithuania and Poland.

[486] The option only applies to those supplies listed in Article 135(1)(b)-(g) of the VAT Directive.

[487] Austria, Bulgaria, Estonia, Lithuania, Poland.

[488] Austria, Belgium, Cyprus, Czechia, Germany, Denmark, Estonia, Finland, France, Hungary, Ireland, Italy, Luxembourg, Latvia, Malta, the Netherlands, Poland, Portugal, Sweden, Slovenia, Slovakia, Spain.

- **All-in clause**. In certain countries, VAT groups must include *all* entities related by financial, economic and organisational links; in other countries, the group can decide to leave certain entities outside of the VAT group.
- **Scope of the activities covered**. In most Member States, there is no limitation to the membership of VAT groups to providers of exempt services. But in three Member States VAT groups are limited specifically to these industries (Malta, Sweden and Finland).
- **Compliance.** Filing a single VAT return is an obligation in every implementing Member State, except for the Netherlands (in which this is optional) and Spain (in which group members must file their own VAT returns). As for the VAT identification number, in eight Member States the VAT group is assigned a single identification number. In nine countries, separate VAT numbers are maintained for control purposes, while in three countries members of the VAT group must use their own VAT number.

VAT groups are in very wide use by companies where available, for the simple reason that for most financial institutions they provide a means to reduce hidden VAT significantly on transactions within the group and on third party overhead costs benefiting the larger group. They are also useful for authorities as a way to streamline VAT administration. In this sense it is clear that, within an exemption regime, the benefits of VAT groups are seen to outweigh the costs.

Nonetheless, the targeted consultation identified **several problems**. Most prevalent among these is the fact that **VAT groups are by nature domestic**, meaning that they cannot be used to reduce the input VAT associated with cross-border supplies within multinational groups. Indeed, for 'very' multinational groups with bases in many Member States, VAT groups can even be detrimental, because the reduction on domestic hidden VAT is outweighed by the additional hidden VAT on transactions with foreign branches[489]. As discussed in Consequence 4, this can also be seen as a barrier to trade in the Single Market.

The **complexity and initial cost of implementing a VAT group**, e.g., adapting IT systems to manage internal VAT flows. Another critical aspect is the determination of the financial, organisational, and economic linkages. In particular, the organisational link has been the topic of recent court cases and created a degree of legal uncertainty both for businesses and tax administrations[490], while in some Member States this requirement has been seen to prevent cooperative banks from forming VAT groups. The so called "all-in, principle"[491] applied in some Member States can also be a deterrent for the use of a VAT group, since it is perceived as too rigid. Another aspect that was reported as hindering the adoption of VAT groups is the joint and several liability: all VAT group members share liability for the VAT payments, of all of the members of the VAT group, meaning that if one member fails to meet its VAT obligations, the others must cover the shortfall. However, stakeholders had mixed views about this aspect, with certain large groups not considering joint liability as a problem.

Cost-Sharing Arrangements (CSAs, being phased out but still available in six Member States). Given their legal status following the 2017 CJEU ruling[492], the main area problem with CSAs is thus their uncertain

[489] As established in CJEU case law (*Skandia* and *Danske Bank*, complemented by VAT Committee guidelines), only entities established in a single Member State can be part of VAT groups therein, and transactions between head offices which are part of a VAT group, and foreign branches are within the scope of VAT. In contrast, when the head office is not part of a VAT group, supplies to foreign branches are considered intra-company transactions, and thus outside the scope of VAT. Therefore, for financial institutions which have many large foreign branches, the advantages of the VAT group may be fully or partly undercut by the additional VAT potentially charged (or accounted for under a reverse charge) on such supplies.

[490] Cf. Judgment of the Court of 1 December 2022, *Finanzamt Kiel v Norddeutsche Gesellschaft für Diakonie mbH*, Case C-141/20 and Opinion of Advocate General Medina delivered on 27 January 2022. *Finanzamt T v S., Case* C-269/20.

[491] I.e. the fact that VAT groups must include all entities related by financial, economic and organisational link.

[492] Judgments of the Court 21 September 2017, *DNB Banka*, C-326/15, EU:C:2017:719 and *Aviva*, C-605/15, EU:C:2017:718. According to the ECJ the exemption provided for in Article 132(1)(f) of the VAT Directive applies only to independent groups of persons whose members carry out an activity in the public interest within the meaning of Article 132, so that services provided by a group whose members engage in an economic activity in the field of financial services, which is not such an activity in the public interest, are not eligible for that exemption.

future and timing for removal where they remain, especially in countries like Italy and the Netherlands where they are in wide use, and where it is unclear whether VAT groups would be suitable due to the limitations described above.

➢ *Definitions of the services covered by the VAT exemption*

Concerning the definitions that determine the VAT treatment of specific services, the majority of these were found to be clear and consistently applied by stakeholders. To the extent that there is uncertainty, it relates mostly to discrepancies in the application of the exemption to five types of services, namely insurance-related services, the management of investment funds and related asset-management services, supporting payment services, derivatives and custody services. Aside from these, it is also noteworthy that innovative services such as those related to crypto-assets are quickly evolving and, required the VAT Committee to interpret existing definitions to identify the most appropriate treatment.

Starting with **insurance-related services**, CJEU case law has (i) defined what constitutes 'an insurance service'[493] and (ii) stipulated that transactions related to insurance services are only exempt when supplied by insurance agents and brokers, with the functions performed being decisive rather than formal qualifications as a broker[494]. While applying these criteria can be complex, the following trends have been consistently observed across Member States:

- **Intermediation services (e.g. conclusion of contracts, issuing / amending / cancellation of policies) are always exempt.** The exemption applies when carried out by insurance brokers or agents, or by other companies. The latter is however a rare occurrence, since, for regulatory reasons, insurance intermediation services and the conclusion of an insurance policy contract can only be carried out by licensed operators[495].
- **Support services other than claims handling are generally taxed,** as they are not considered 'insurance-related services'. The exemption could apply when these services are supplied by an insurance intermediary and are considered ancillary to the provision of insurance or intermediation services, e.g. only to the intermediary's direct customers or without separate payments. The application of the exemption depends on the case at stake and the contractual arrangements. Claims handling by brokers and agents is generally exempt.
- **Insurance-related services, including claims handling, carried out by companies other than insurance brokers or agents are usually taxed.** In a few jurisdictions[496], however, the interpretation of the *Aspiro* criteria is less restrictive, resulting in a wider application of the exemption. For instance, in Ireland, claims handling and other back-office support can be exempt when it forms an 'integral part of the insurance contract'.

When it comes to the **VAT treatment of the management of investment funds and asset management**, the CJEU's jurisprudence dictates that the management of Undertakings for Collective Investments in Transferable Securities (UCITS)[497] and funds equivalent to UCITS[498] must be exempt, which the study has

[493] According to the CJEU, an insurance service consists of "the insurer undertaking, in return for prior payment of a premium, to provide the insured, in the event of materialisation of the risk covered, with the service [or indemnity] agreed when the contract was concluded", cf. CJEU judgment of 17 March 2016, *Aspiro*, C-40/15, EU:C:2016:172.

[494] Two conditions related to the activities performed should be met: (i) the service provider has a relationship with both the insurer and the insured party, either directly or via another intermediary; and (ii) the activities must include the essential tasks of brokers and agents, such as finding prospective clients and introducing them to the insurer. CJEU judgment of 3 April 2008, Beheer, C 124/07, EU:C:2008:196.

[495] Cf. Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast) Text with EEA relevance, Article 3(1) of the Insurance Distribution Directive.

[496] E.g. Ireland, Luxembourg, Sweden.

[497] UCITS are subject to a dedicated regulatory framework and can be marketed to final consumers throughout the Single Market. *Cf.* Directive 2009/65/EC.

[498] Based on meeting several conditions laid out in CJEU judgment of 9 December 2015, *Staatssecretaris van Financiën v Fiscale Eenheid X NV cs*, C-595/13, EU:C:2015:801, in particular §§ 32 and 33.

duly found to be the case. However, a number of differences have been found concerning other types of funds, the treatment of which for the 12 fieldwork Member States is summarised in the table below.

Table 41. VAT Treatment of management of investment funds

	UCITS	Alternative Investment Funds	Pension funds
Exempt	All fieldwork Member States	Germany, France, Italy, Lithuania, Luxembourg, Malta, Netherlands, Poland, Sweden	Germany, Italy, Malta, Spain
Partly exempt	-	Spain, Ireland	Only defined contribution: Ireland, Lithuania, Luxembourg, Netherlands, Poland, Sweden, France and Greece
Not exempt	-	Greece	-

Source: Authors' elaboration based on 2025 legal mapping

The second problematic area concerns asset management services (as distinct from the management of investment funds described above) are understood for VAT purposes as investment management, in the definition of the UCITS Directive. To benefit from the exemption, asset management services must form a distinct whole, and [be] specific to, and essential for, the management of the special investment funds'[499]. Specific and essential services encompass the functions that can be carried out by asset managers according to Annex II of the UCITS Directive (including investment advisory services in certain circumstances[500]), but not mere technical supplies[501]. In addition, **these services can be exempt only when provided to a collective investment fund**, thereby excluding the management of individual portfolios both for households / consumers and for corporations and other financial institutions[502].

As summarised in Table 42, national approaches differ with regard to asset management services provided to pension funds, depending on (except in the case of France) whether the fund itself benefits from the exemption; and services provided to financial intermediaries, where the question often hinges on whether there is a 'collective' element (e.g., management of assets underlying life insurance policies in Italy).

Table 42. VAT Treatment of asset management services

	To collective investment funds	To pension funds	To financial intermediaries
Exempt	All fieldwork Member States	Greece; Spain; Ireland; Italy; Lithuania; Luxembourg; Malta; Poland	Ireland; Greece
Exempt under specific conditions		Netherlands; Sweden	Germany, Italy; Sweden
Not exempt		France	Spain, Lithuania; Luxembourg; Malta; the Netherlands; Poland

Source: Authors' elaboration based on 2025 legal mapping

[499] CJEU judgment of 4 May 2006, *Abbey National*, C-169/04, EU:C:2006:289, at § 67., at § 72. See also CJEU judgment of 2 July 2020, *BlackRock Investment Management (UK) Ltd* (C-231/19), EU:C:2020:513.

[500] CJEU judgment of 7 March 2013, *GfBk Gesellschaft für Börsenkommunikation mbH v Finanzamt Bayreuth*, C-275/11, EU:C:2013:141.

[501] Such as general administration, depositary functions, or the provision of IT services.

[502] CJEU judgment of 4 May 2006, *Abbey National*, C-169/04, EU:C:2006:289, at § 67.

As for **advisory services,** in line with the VAT Committee's Guidelines[503], they are not considered by the Member States to amount to 'negotiation in securities' and thus cannot benefit *per se* from the exemption in Article 135(1)(f) of the VAT Directive. However, they can be considered as ancillary to the negotiation in securities, and thus be exempt when the adviser also acts as an intermediary in the purchase or sale of the securities[504]. This is the situation in all fieldwork Member States, though the stringency of the conditions may vary. This results in a lack of legal certainty on the application of the exemption to such services, as the VAT Committee guidelines are not legally binding.

The third source of uncertainty is the VAT treatment of **supporting payment services**, for which the CJEU has had to intervene in a number of cases to determine the criteria to distinguish between payment services as such, which are exempt, and other supporting services, which are taxable. The criteria were set out first in the SDC judgment[505] in which the CJEU stated that supporting services can be covered by the exemption, provided that: (i) they form a distinct whole; and (ii) they are specific and essential for the provision of the exempt financial services. What is 'specific and essential' to the execution of the payment services is the transfer of funds and changes in the legal and financial situation of the parties to the transfer[506]. In all fieldwork countries, the situation was found to be uniform, with the exemption only applying to services consisting of the transfer of funds, with no distinction made concerning the nature of the supplier.

That said, the targeted consultation showed that the varying treatment of payment services remains a concern, specifically **depending on whether the various services in the payment value chain are provided by a banking institution as a whole, or supplied by other specialist entities** (e.g. a fintech provider). This would affect the level playing field: fintechs providing specialised payment support services to banks of bear no hidden VAT, and hence the ensuing payment services are more competitively priced compared to when the whole supply is made by the banking institutions.

This is compounded by **regulatory uncertainty**, which **concerns not the application of the rules per se, but rather fintech business models**, which are relatively newly emerged and of growing importance. More specifically, banks typically bundle together supporting services and payment services *stricto sensu*, which are then provided to final customers; the whole bundle is exempt. In contrast, fintechs often specialise in the provision of only certain payment supporting services, such as handling and checking of customers' data and supporting IT components, which are taxable (hence, generating no hidden VAT). This is a consequence of the fact that new payment-related services have emerged that could not be conceived when the exemption was drafted in the Directive, and also when the leading case – SDC – was adjudicated by the CJEU.

Fourthly, the study has also found some divergence in the field of derivatives. This relates mainly derivative transactions with a physical underlying. In particular, in 10 of the 12 fieldwork Member States[507], derivatives linked to physical goods are only exempt when physical delivery of the underlying good is not provided, and /or when the good is traded in regulated markets. The other two Member States (Greece and Ireland) explicitly tax these transactions.

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[503] VAT Committee Guidelines resulting from the 104th meeting of 4-5 June 2015, taxud.c.1(2015)4694162 – 875, Document B.

[504] Cf. Judgment of the Court of 13 December 2001, *Commissioners of Customs & Excise v CSC Financial Services Ltd.*, C 235/00, EU:C:2001:696.

[505] CJEU judgment of 5 June 1997, Sparekassernes Datacenter (*SDC) v Skatteministeriet*, C-2/95, EU:C:1997:278.

[506] This interpretation of the definition was confirmed in subsequent recent judgments, such as Bookit (on credit card data handling), AXA UK and DPAS (on the management of debit plans and direct debits), and Cardpoint (on ATM services). Cf. Judgment of the Court of 26 May 2016, *Bookit, Ltd v Commissioners for Her Majesty's Revenue and Customs*, C 607/14, EU:C:2016:355; Judgment of the Court of 28 October 2010, *Commissioners for Her Majesty's Revenue and Customs v. AXA UK plc*, C 175/09, EU:C:2010:646; Judgment of the Court of 25 July 2018, *Commissioners for Her Majesty's Revenue and Customs v DPAS Limited*, C 5/17, EU:C:2018:592; Judgment of the Court of 3 October 2019, *Finanzamt Trier v Cardpoint GmbH*, C 42/18, EU:C:2019:822.

[507] Specifically, France, Germany, Spain, France, Italy, Luxembourg, Lithuania, Malta, the Netherlands, Poland, Spain and Sweden.

Lastly, the **treatment of custody services provided by global custodians varies** in two respects. Some Member States (e.g. Luxembourg) consider bundled custody services as a single exempt supply. Second, while physical safekeeping is generally taxed, Member States differ with regard to approaches to electronic safekeeping, which is relevant for the treatment of services related to cryptocurrencies.

As mentioned, aside from the issue mentioned with custody services, **the VAT treatment of innovative services such as the exchange of crypto-assets has not currently been found problematic**. Still, it required stretching the existing definitions, which only partly adapt to this new phenomenon. The exchange of crypto assets or fiat currencies is broadly recognised as VAT exempt, being equated to transactions in currencies[508]. The VAT Committee and approaches by Member States are also consistent when it comes to the VAT treatment of the storage and transfer of cryptocurrencies, e.g., in the case of services allowing users to hold and operate digital wallets, which are generally exempt; and the trade of Non-Fungible Tokens (NFTs), the trading of which is generally taxed[509]. Recently, the CJEU limited the VAT exemption (under Hedqvist, C-264/14) to decentralised cryptocurrencies functioning as alternative means of payment (e.g., Bitcoin). Centralised, game-specific virtual currencies (e.g., in-game tokens, NFTs tied to platforms) are now explicitly excluded from the exemption. These are classified as taxable digital services, not financial transactions or vouchers. The terms of service must distinguish between exempt decentralised cryptocurrencies (e.g., Ethereum) and taxable centralised virtual items (e.g., skins, loot boxes, proprietary tokens).

That said, some scholars investigating the VAT treatment of crypto assets argue that crypto currencies have evolved into instruments predominantly used for speculative purposes. This makes the definition of currency unapplicable in those cases[510], and could be a future area of divergent approaches and uncertainty. More specifically, the treatment of decentralised finance (DeFi) services[511] - e.g., decentralised crypto exchanges, liquidity pool operators, staking intermediation services – creates issues. The main challenge identified is that DeFi transactions are executed through smart contracts based on autonomous protocols, making it uncertain whether the exemptions for 'negotiation' in financial transactions would apply to fully automated services[512].

➢ *Sectoral taxes*

Unlike for VAT, determining the tax base and administering the sectoral taxes examined for the study was generally seen as relatively simple, in large part because the required information is usually known already for business or sectoral-regulatory reasons. **Complexity and uncertainty therefore stemmed from the diversity in types of taxes and their sheer number**, especially for providers operating in multiple Member States. As discussed in Driver 5 above, 92 tax measures were identified across six distinct categories. At the country level, the number of measures in place averaged just over three, with wide variation from just a single tax (the case for six Member States) to 10 in Ireland and 11 in Portugal.

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[508] VAT Committee Guidelines Resulting from the 120th Meeting of 28 March 2022. Cf also VAT Committee Guidelines resulting from the 102nd meeting of 30 March 2015, taxud.c.1(2015)5528628 – 870 (1/2), Document H.,

[509] Value Added Tax Committee (Article 398 of Directive 2006/112/EC) Working Paper No 1080, Question Concerning the Application of EU VAT Provisions, *Cf also* VAT Committee (2023), Value Added Tax Committee (Article 398 Of Directive 2006/112/EC) Working Paper No 1060, Question Concerning The Application Of Eu Vat Provisions.

[510] Joachim Englisch, Contribution to the Study on the challenges of VAT beyond VAT in the Digital Age (on file with the authors).

[511] Decentralized finance (DeFi) is an emerging peer-to-peer financial system that uses blockchain and cryptocurrencies to allow people, businesses, or other entities to transact directly with each other. https://www.ecb.europa.eu/press/financial-stability- DeFi participants are part of a peer-to-peer network (built on a public blockchain) where assets represented in the network can be transferred automatically (via so-called smart contracts). Cf Born, A., Gschossmann, I., Hodbod, A., Lambert, C., & Pellicani, A. (2022). Decentralised finance–a new unregulated non-bank system? European Central Bank.

[512] See also Brassfield / Dawaki / Mason, Impact of decentralized finance on VAT rules, 11/03/2025 working paper, at 4. Other interpretative issues analysed by scholars include different technical designs of staking services (staking pool vs. staking as a service) may result in a non-neutral application of VAT exemptions *cf* Cf. CJEU 14 July 2011 – C-464/10, Henfling, ECLI:EU:C:2011, para. 38.

With regard to **specific taxes**, a degree of uncertainty and complexity was found for indirect taxes (particularly IPTs) and windfall taxes. For the former, some insurance companies highlighted the challenge of navigating different IPT frameworks in each Member State where they operate, which often requires them to rely on local consultants, even for minimal operations in a given country. Instances of double taxation were also highlighted. As for windfall taxes, stakeholders focused on the uncertain duration of some taxes, especially since initial timeframes were often extended. In its opinions on national windfall taxes[513], the ECB has found that a lack of EU-wide coordination risks fragmenting the financial system, distorting competition, and creating double-taxation issues for internationally active banks.

9.4 Consequences

This section assesses the consequences of the problems described above, in each case gauging magnitude in terms of a three-point scale (minor, moderate, significant) and quantifying the results where possible.

9.4.1 Consequence 1 – Complex and costly tax compliance for providers of financial services

Overview. Providers of financial services and tax authorities face costs to comply with the VAT exemption and sectoral taxes, comprised mainly of administrative burdens such as determining whether a particular tax applies to a certain activity or service, maintaining accurate records, reporting, and responding to questions or audits from tax authorities, as well as – in rare situations – litigation. The complexity of compliance plays a substantial role in the costs. Moreover, the VAT exemption was found to be more burdensome than standard VAT treatment, while for sectoral taxes the fragmented tax framework added to the costs.

Magnitude. Moderate – the administrative costs are important in absolute terms and widely considered in excess of the administrative costs of standard VAT treatment applied to other sectors, while also being felt more prominently among smaller providers of financial services; at the same time, for the larger providers of financial services making up the majority, the costs accounted for only very small shares of turnover and staff costs.

Analysis. Administrative costs were calculated separately for the VAT exemption and sectoral taxes, in each case relying on a combination of input from the targeted consultation and desk research sources (see details in 7.2). The analysis distinguishes businesses with a turnover above and below EUR 2 billion, since a notable break was observed in the data around this threshold. For sectoral taxes, an additional distinction was made between banks and insurance companies, which face greater numbers of taxes and burdens, and asset managers, which face fewer. The headline results are presented in the Table 43 below, with administrative costs for businesses estimated at about EUR 1.3 billion per year for VAT and close to EUR 900 million for sectoral taxes. Relative to key indicators, these costs account for less than 1% of turnover or staff costs, though in relative terms both aspects are considerably more important for smaller entities.

[513] ECB, Opinion of the European Central Bank of 26 November 2019 on increasing the special levy on selected financial institutions, CON/2019/40. Specifically paragraph 2.1, referenced in the opinion on the Spanish windfall tax; see also ECB, Opinion of the European Central Bank of 4 April 2023 on the imposition of a temporary solidarity contribution, CON/2023/9. Opinion on the Lithuanian windfall tax highlights the risk of market fragmentation and potentially distorted competition, though acknowledging that the tax's design makes efforts to target specifically windfall profits and to avoid harming credit institutions' resilience.

Table 43. Administrative costs borne by financial services providers (EU averages, with some variation by Member State depending on the number of sectoral taxes applied)

	Personnel time (median)	Personnel cost (EU median - EUR)	External costs (median - EUR)	Annual cost per company (EUR)	Company population	Aggregate admin costs (million EUR)	Total (million EUR)
Costs for compliance with VAT obligations							
Smaller entities (< EUR 2 billion turnover)	1 FTE	64,000	15,000	80,000	15,003	1,200	1,300
Larger entities (>EUR 2 billion turnover)	3 FTEs	193,000	50,000	240,000	374	90	
Costs for compliance with sectoral taxes							
Smaller banks & insurances	1 FTE	64,000	5,000	70,000	8,212	570	870
Larger banks & insurances	3 FTEs	193,000	20,000	215,000	205	45	
Smaller asset managers	0.5 FTE	32,000	3,000	35,000	6,725	235	
Larger asset managers	1.5 FTEs	97,000	10,000	105,000	168	20	

Source: Authors' elaboration based on sectoral analysis, stakeholder consultation[514], Orbis database, and Eurostat

Finally, asked to compare with standard VAT treatment, among providing input to the question, about two thirds of respondents to the targeted consultation considered compliance with the exemption to be more burdensome. This was attributed to the complexity of VAT treatment, difficulties in deducting input VAT, burdensome tax audits and the need to adapt IT systems and internal processes. Specific elements generating higher burdens include:

- Businesses must **distinguish between taxable (and those giving rise to the right to deduct) and exempt (without credit) services**, a process that is often not straightforward and requires significant resources. For credit institutions and insurance companies, determining which transactions qualify for the exemption can be particularly challenging. The lack of harmonisation across Member States further complicates cross-border transactions, leading to uncertainty and increased administrative costs. The targeted consultation identified additional burdens from determining the correct VAT treatment for intra-group or intra-company cross-border dealings.
- Unlike fully taxable businesses, VAT-exempt entities cannot fully reclaim input VAT, making **proportional deductions a major administrative challenge**. Pro-rata calculations must be conducted to determine deductible VAT amounts, requiring businesses to track and document mixed-use inputs meticulously. The granularity required in tracking input VAT for different business segments results in high manual effort, frequent adjustments, and audit risks. Tax authorities frequently challenge VAT deduction claims, leading to lengthy audits and potentially disputes.
- More generally, financial institutions bemoaned that the high degree of **legal uncertainty** over the scope of the VAT exemption and its application results in more burdensome administrative

[514] Cf Volume 2 – Annex 1.

processes. Among others, operators often mention the lack of clarity over definitions (i.e. whether a service is in fact exempt or not) and proportional deduction methods.

- VAT-exempt entities need **tailored IT systems** to track exempt versus taxable transactions, calculate pro-rata deductions, and generate compliance reports. Enterprise resource planning (ERP) system modifications are costly and time-consuming, requiring companies to update and adapt their systems to changing VAT interpretations. Automating VAT compliance for exempt transactions is far more complex than for standard VAT treatment, often requiring manual adjustments.

Partly offsetting these burdens is the fact that exempt supplies benefit from certain simplifications, particularly regarding invoicing and reporting requirements. Still, the overall perception was that these benefits are more than outweighed by the additional complexities of dealing with the exemption.

9.4.2 Consequence 2 – Reduced VAT revenues and incoherence with sectoral taxes

Overview. The VAT exemption results in significantly lower VAT liability compared to what would be expected from the financial sector's economic importance. This is due both to the fact that VAT is not applied to financial services outputs, and the ability of financial institutions to use structural provisions such as VAT groups to reduce the amount of irrecoverable input VAT on internal recharges.

At the same time, the financial sector is subject to a wide range of specific sectoral taxes, some of which (e.g. many IPTs, payroll taxes) have been devised to compensate for the VAT exemption. In some cases, these sectoral taxes result in a higher burden than VAT. IPTs, which are the largest among the sectoral taxes examined, are often charged at a rate similar or equal to the standard VAT rate, but have no deduction rights associated thereto. Hence, on B2B supplies, IPTs result in a higher taxation compared to VAT. Furthermore, hidden VAT adds on top of IPT. In other cases, e.g. the payroll taxes in France and Denmark, the rate is set at a lower level compared to standard rate, and hence accounts for the hidden VAT which is borne by suppliers of exempt services. The other sectoral taxes (e.g., financial transaction taxes, financial institution levies, windfall taxes) are independent from the VAT framework and are not aimed at compensating for the exemption. The resultant patchwork of taxes creates risk of incoherence between VAT on the one hand and sectoral taxes on the other.[515]

Magnitude: Significant – the VAT liability of the financial sector was 72.4 billion in 2023, while the VAT policy gap', which is defined by the difference between actual VAT liability and the notional ideal revenue[516] that could be expected if all financial sector output was taxed at standard VAT rates, amounted to EUR 52.2 billion in 2023, representing 4.4% of EU VAT revenues. For their part, sectoral taxes are high in number (92) and correspond to many different priorities across Member States, leading to fragmentation and risks of incoherence.

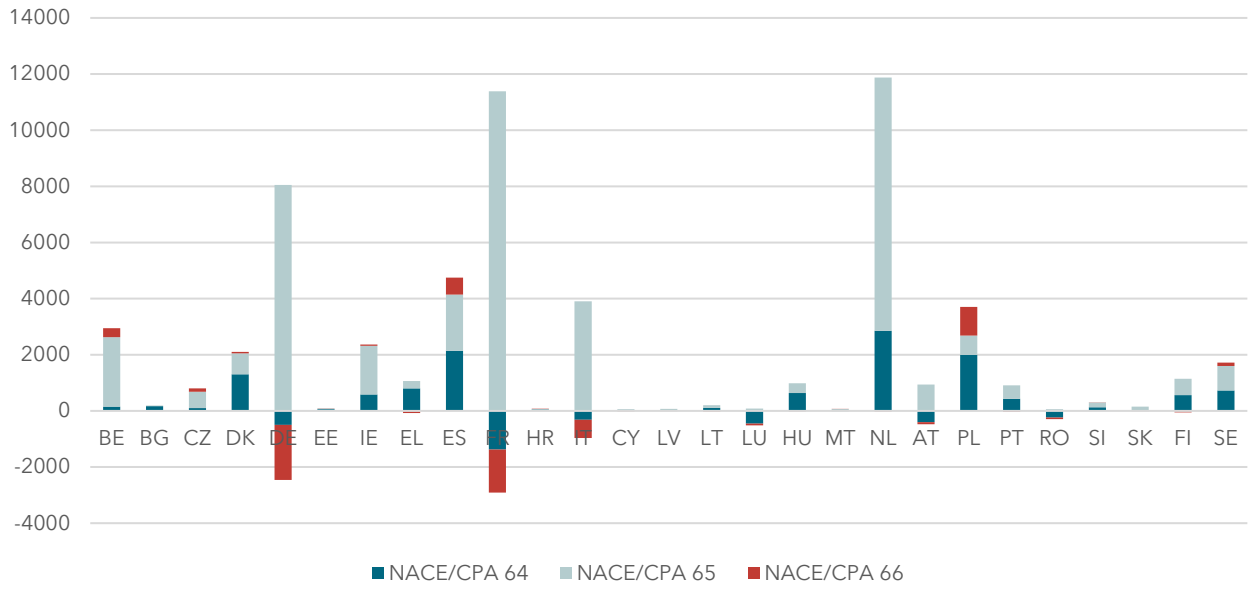
Analysis. The policy gap of EUR 52.2. billion can be broken down into **EUR 9.6billion as attributed to the banking sector and EUR 44.9 billion to the insurance industry, while the gap for other financial services was negative, at EUR -2.3 billion**. In other words, if all financial services were to become taxable, the VAT liability on the use of services provided by investment services companies (K66) would decline. This is because these services are mostly used as intermediate inputs (B2B transactions).

[515] The study only considers a subset of taxes applicable to the financial sector, i.e. VAT and sectoral taxes, and do not cover other forms of taxation, in particular corporate income taxes. For this reason, it does not assess whether the financial sector as a whole is more or less taxed than other sectors in the economy.

[516] Notional ideal revenue is the theoretical, counterfactual VAT liability that would result from applying the standard VAT rate universally to aggregate net final consumption and housing investment. The theoretical approach to NIR naturally omits various economic effects, particularly general-equilibrium and second-order effects that would likely occur due to increased tax rates and the removal of exemptions. It also does not account for imperfect compliance. While these assumptions simplify reality, the VAT policy gap remains a valuable measure of the impact of exemptions on VAT liabilities. The policy gap estimation methodology allows VAT policy structures to be modelled in detail, including variations in tax rates across different types of use. This provides a clearer understanding of how exemptions influence VAT revenue.

The ratio of policy gaps for the three analysed subsectors was rather consistent between countries (see Figure 76), with the largest gaps in the Netherlands (EUR 11.9 billion), France (EUR 8.5 billion), and Germany (EUR 5.6 billion). In contrast, **the policy gap was negative in two Member States (Luxembourg and Romania)**. The negative gap was largest (both in nominal terms and as a share of national VAT revenue) in Luxembourg (see Figure 77). This is due to its relatively large value of financial services and the fact that they are used primarily as intermediate inputs or exported. Romania also shows relatively high shares of B2B consumption of financial services. For all three of the countries with a negative gap, it follows that, in a counterfactual scenario in which these services were taxed, the financial sector would be able to deduct input VAT, in turn reducing VAT revenue.[517] At the same time, the relative B2B vs B2C shares mean business customers would deduct as input VAT the VAT charged.[518]

Figure 76. VAT policy gap for services provided by the financial sector (by subsector, EUR million, 2023)



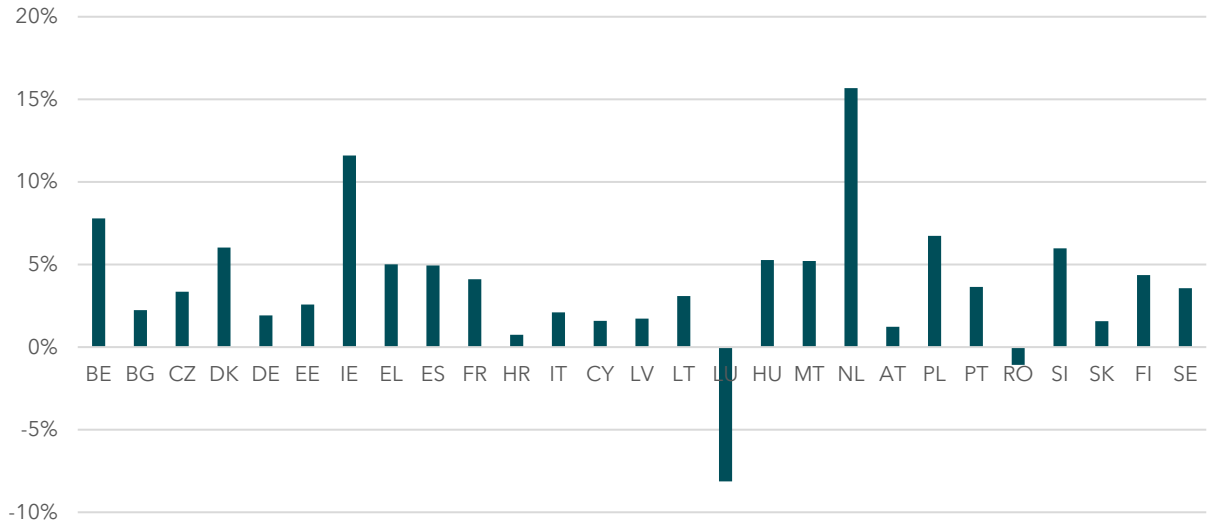
Source: Authors' elaboration on the basis of Volume 2 – Annex 3.1 (Table 27)

In relative terms, the total policy gap attributed to services provided by the financial sector represents 2.9% of actual (total) VAT revenue, which is equivalent to 1.5% of the notional ideal revenue. The largest policy gaps in relative terms were estimated for the Netherlands (14.8% of actual VAT revenue), Poland (6.6%) and Belgium (5.9%). In these countries, the financial sector is relatively large, and the current effective VAT rates (6% and 4.5% for B2C and B2B transactions on average, respectively) are much lower than the EU average. Apart from these countries and those with negative policy gaps, the policy gaps in other Member States ranged from 0% to 5% of VAT revenues.

[517] European Commission: Directorate-General for Taxation and Customs Union, Bonch-Osmolovskiy, M., Poniatowski, G., Braniff, L., Harrison, G. et al., VAT gap in the EU – 2024 report, Poniatowski, G.(editor), Publications Office of the European Union, 2024, https://data.europa.eu/doi/10.2778/2476549.

[518] In a counterfactual extreme situation where financial services are only purchased by taxable businesses, bringing supplies by financial service providers into the VAT system (by applying VAT to their services) would only result in the financial sector being able to deduct input VAT while not having any impact on the revenue collected at the final stage of the value chain.

Figure 77. VAT policy gap for services provided by the financial sector (% of actual revenue, 2023)



Source: Authors' elaboration based on Eurostat, DG TAXUD (VAT Gap in Europe study) and direct data submissions from Member State tax administrations. See Volume 2 - Annex 3.1 for estimates on output and deductible input VAT broken down by Member State and sector of economic activity

The main cause of the policy gap is the fact that VAT is not charged on financial services outputs. Another contributing factor is the existence of structural provisions that help companies to reduce hidden VAT. The economic analysis done for the study showed that this was most pronounced for VAT groups. In the 21 Member States where available, these were found to reduce hidden VAT by an estimated EUR 4 to 16 billion (i.e., from 0.3% and 1.2% of sectoral turnover); the reductions were more pronounced in the insurance sector, since this industry makes almost exclusively exempt supplies and thus without VAT groups has very little scope to deduct input. Each country's choice of proportional deduction method also makes a difference. For banking and other financial services[519], those countries mandating actual use (Austria, Germany, Finland and Romania) saw deductions of only around 1%, compared with deductions of 6-7% from these sectors in countries using any other method.

Against this backdrop, a number of **national sectoral taxes have been introduced in part to offset the negative revenue impacts of the VAT exemption**. Most important among these are IPTs, which are applied in 21 Member States and brought in EUR 54 billion in 2023, in addition to another 9 taxes on the sale of financial and insurance products[520] accounting for EUR 9 billion in revenue. The payroll taxes applied in France and Denmark are also linked to the exemption. More generally, these and other national sectoral taxes reflect national priorities and fiscal strategies and are not entirely coordinated with the VAT framework, causing risks of incoherence and fragmentation.

[519] The choice of deduction method was found to make very little difference in insurance for the same reason that VAT groups are helpful for this sector, namely that its output is comprised almost fully of exempt supplies.

[520] IPTs are classified as a specific sub-category of taxes on the sale of financial and insurance products, making up the majority of the broader category (i.e. 40 out of 49 tax measures and EUR 54 out of EUR 63 billion in revenue).

9.4.3 Consequence 3 – Tax-induced disincentives to investment, particularly in innovative practices and specialisation

Overview. When businesses are incentivised to develop services internally rather than sourcing them from specialist providers, this may limit demand from external suppliers and thus slow down in particular in the current context for financial services, innovation and technological advancement.

Magnitude. Moderate (but becoming more significant) –the current issues are real, though not assessed as major. However, continued trends towards specialisation and outsourcing (driven by the fintech ecosystem) will exacerbate the effects, leading to decisions that are rational in the short term but cumulatively negative over time.

Analysis. As described in Problem 1 above, tax-induced distortions mean that both groupsourcing and outsourcing impose an additional tax burden from hidden VAT, equal to the standard VAT rate weighted by the share of non-deductible VAT. Unlike in other jurisdictions like Australia, New Zealand and Singapore, only limited means exist to bring down hidden VAT, especially when it comes to external suppliers. Financial services providers are thus incentivised to produce services in-house to the greatest feasible extent.

9.4.4 Consequence 4 – Inconsistency of the tax framework with EU policies on the Single Market and competitiveness

Overview. As explained in Section 9.1.4 above, EU policies such as the CMU and SIU, as well as mechanisms such as passporting, aim to facilitate the integration of the EU Single Market for financial services and boost the competitiveness of EU financial industry. This is inconsistent with the tax framework for the sector, which is fragmented in ways that could pose barriers to trade across borders and fail to provide a level playing field in the EU, and put EU providers of financial services at a disadvantage compared to competitors in third countries.

However, while cross-border trade in financial services remains marginal compared to other sectors, and concentrated in certain segments, this is mostly due to barriers other than taxation, such as national regulatory frameworks. Still, the importance of the tax framework as a barrier could increase over time if other barriers progressively come down.

Magnitude – Minor in comparison to regulatory barriers but the effects could become relatively more important as other barriers to trade in the Single Market come down.

Analysis. The above-described market distortions, fragmented tax framework and accompanying complexity and legal uncertainty, along with brakes on innovation, could combine to increase barriers to trade in the EU Single Market. These could also hamper the global competitiveness of the EU financial sector, which may also face tax competition from third countries in certain situations.

The context is formed by the limited nature of cross-border trade in the financial sector. While it is dominated by large firms and highly internationalised, in practice most services are provided by domestic firms or locally established branches and subsidiaries. The exception is fund and asset-management services, for which the market is essentially intra-EU, with suppliers concentrated in a few financial centres. Financial services imported from third countries (mainly the UK and US) are prominent in niche areas such as alternative investments, payment services and specialised services such as rating services and economic and financial databases, as well as certain insurance segments like reinsurance and unit-linked life insurance.

As noted, **the VAT exemption and sectoral taxes do impact compliance and tax obligations. In certain cases, these have been shown to influence corporate behaviour**, such as with Nordea's recent decision to move its headquarters from Sweden to Finland[521], or the decision (highlighted in the targeted

[521] Specifically, this related to the tax base for the bank levy, which captures all revenue for entities headquartered in Sweden but is limited to revenue in Sweden for the branches of foreign firms. This was mentioned in the targeted consultation as well as reported in the media, e.g., https://www.reuters.com/article/business/banking-group-nordea-snubs-sweden-with-hq-move-to-finland-idUSKCN1BH28R/.

consultation) following Brexit for some major American banks to relocate to France rather than Ireland due to the attractiveness of the former's option to tax regime. The presence of a windfall tax can also affect the attractiveness of a market for new operations, or where to register balance sheet activity. However, the targeted consultation found that **taxes are one factor among many, and seldom substantial enough to drive or act as a barrier to cross-border operations in general terms**. Other considerations, such as strict regulatory requirements (which often mandate or incentivise a local presence), expertise, and product availability, in addition to cultural and language, are much more important in determining where and how services are supplied.

When it comes to **international competitiveness, specific sources of potential competitive tax disadvantages were identified**. These include the burden of hidden VAT when EU and non-EU firms compete for EU-based customers, or from competition with EU branches of firms headquartered in third countries. The specific approaches of third countries – such as the UK's more flexible approach to VAT grouping described above – can also affect relative competitiveness with trading partners at the margin. However, while these impacts could not be quantified, consulted providers of financial services and business federations considered that they materialised rarely, and only for specific types of services, such as payment processing. The fragmented tax framework was also considered a potential barrier to consolidation and mergers, but marginal compared to regulatory and political factors. Separately, recent evidence suggests that tax burdens can affect the financial performance of banks, and investor perceptions, though relative effects on the EU financial sector compared to other jurisdictions has not been systematically compared[522].

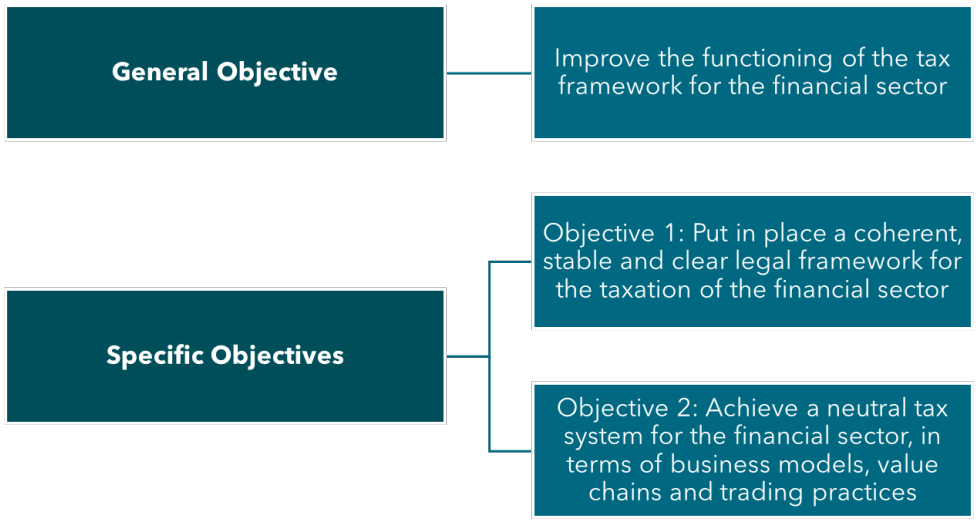
Taken together, the impacts of the tax framework on cross-border trade and competitiveness appear to be real, if limited in scale compared to other factors. However, as progress is made on the sectoral policies mentioned above, namely the CMU and SIU, the barriers that are currently much more important, particularly those of a regulatory nature, may gradually come down. In such a scenario, it would be conceivable that continued tax fragmentation and compliance issues could slow down integration if not addressed.

[522] cf. Risk Assessment Report by European Banking Authority, available at: https://www.eba.europa.eu/publications-and-media/publications/profitability-0?utm; and, on the Italian windfall tax: https://www.reuters.com/markets/europe/italian-windfall-tax-sends-euro-zone-bank-stocks-tumbling-2023-08-08/?utm_. (last accessed May 2026)

10. Policy objectives

As per Tool #15 of the Better Regulation Toolbox, objectives for a potential initiative are expressed in terms of a general objective at the policy level that the initiative would contribute to, and specific objectives setting out more concretely what the initiative would seek to achieve. The objectives are depicted in Figure 78 below, then described in more detail. They then act as a framework for the identification of policy considerations, which are discussed in the next chapter.

Figure 78. Objectives tree



Source: Authors' elaboration based on the assessment of the current situation and problem analysis

The starting point is the problem analysis discussed in the previous chapter. Taking together the two core problems of tax-driven distortions and an uncertain, complex and fragmented tax framework, it can be said that, overall, the tax framework for the financial sector in the EU is functioning insufficiently well. The general objective of the initiative would be to address this situation, and can thus be defined as: improve the functioning of the tax framework for the financial sector. This objective would capture a broad range of potential policy actions to address the drivers, problems and their consequences.

Two specific objectives have been defined to contribute to the general objective. The first of these is to put in place a coherent, stable and clear legal framework for the taxation of the financial sector. This objective responds to the complexity and uncertainty generated by the interaction between the VAT exemption, divergent national interpretations of EU VAT rules, and the proliferation of sectoral taxes at national level. Legal uncertainty increases administrative costs for businesses, complicates tax planning and administration, and can discourage cross-border trade, particularly for smaller businesses.

A more coherent and stable tax framework would help ensure that similar activities are treated consistently across Member States and over time. This is particularly important in a sector that is inherently international and increasingly reliant on integrated EU and global value chains. Clarity in the tax rules would also enhance transparency and predictability, allowing financial institutions to make investment and organisational decisions based on economic fundamentals rather than tax considerations. From a public policy perspective, a clearer framework would also facilitate enforcement and reduce the risk of disputes and litigation, thereby improving the overall efficiency of tax administration.

The second specific objective is to achieve a neutral tax system for the financial sector in terms of business models, value chains and trading practices. Neutrality in these respects is a core principle of effective taxation systems, against which the current framework falls short. The issues are specifically acute in the area of VAT, where the lack of full deduction rights for financial institutions creates incentives for financial institutions to internalise activities that could otherwise be outsourced more efficiently, and to favour certain business models or transaction structures over others for tax reasons rather than economic merit.

Achieving greater tax neutrality does not necessarily imply identical tax treatment for all financial services or activities. Rather, it means reducing undue differences in effective tax burdens that arise solely from the design of the tax system, and ensuring that taxation does not cause distortions or otherwise systematically favour or penalise particular business decisions or trading practices. By moving closer to a neutral framework, the initiative would support more efficient allocation of resources within the financial sector and support the competitiveness of the EU financial sector.

11. Policy considerations

11.1 Introduction

This chapter presents the policy considerations (i.e., measures that could form a future policy initiative) identified to address the objectives defined in the foregoing chapter. The considerations are based on the results of the assessment of the current situation, as well as the results of the targeted consultation and discussion with DG TAXUD, and have been designed to address the problems and objectives outlined in the foregoing chapters.

The **policy considerations are grouped into three building blocks**, which are briefly outlined here and in Table 44 below. After an overview of the legal mechanisms that would be used to implement the policy considerations, the rest of the chapter focuses on each building block in turn before concluding with the intervention logic for the potential future initiative. The impacts for each building block and policy consideration are then analysed in Chapters 12-14. Chapter 15 then discusses the impacts of complementary packages of policy considerations from across the building blocks, since these could also form a coherent policy choice.

1. **Modernisation and simplification of the current rules for VAT**: this includes changes to the VAT Directive which have no or very limited impact on the scope of the exemption but would aim to improve its functioning in various ways, in particular with respect to the definitions of financial services and the proportional deduction rules.
2. **Introduction of measures to reduce non-deductible VAT for the financial sector**: these policy considerations aim to reduce the distortions associated with hidden VAT, including on cross-border supplies and within corporate groups, and encompass changes that would make mandatory the availability of VAT groups and the option to tax (both of which the Member States may currently choose to implement or not), as well as re-introducing cost-sharing arrangements (CSAs).
3. **Revisiting of the VAT exemption for financial services and introduction of harmonisation measures in sectoral taxes**: under this block, the current exemption from VAT on financial services would be fundamentally reformed. Specifically, this includes considerations to remove the VAT exemption entirely, or – given the practical and political challenges of applying fee to services remunerated based on interest rates – only for fee-based services. In both cases, a range of VAT rates would be used, and sectoral taxes would also be removed as relevant to avoid double- / over-taxation. For reasons of simplification, the possibility for the Member States to allow the option to tax would not be retained under the VAT Directive. As an alternative reform, this block also includes a policy consideration that would introduce a Financial Activity Tax (FAT); this would be coupled with the VAT zero-rating of financial services to restore the right of deduction, while sectoral taxes would be removed with a view to streamlining and simplifying the tax framework. This block will also include potential accompanying measures, including (i) an amendment to the Capital Duty Directive (CDD)[523], specifically to further harmonise the implementation of the legislation by eliminating the transitional measures that remain in place for four Member States; and (ii) non-binding coordination of sectoral taxes.

Table 44. Overview of policy considerations

Building Block	Policy considerations	Further details and variants
1. Modernisation and simplification of the current rules for VAT	1A. Modernisation of the definitions of the VAT exemption	The analysis focuses on modernising several definitions identified as insufficiently clear, outdated or inconsistently implemented, namely (i) the management of certain collective investment funds, (ii) supporting payment services, (iii) intermediation and insurance-related services,

[523] Council Directive 2008/7/EC of 12 February 2008 concerning indirect taxes on the raising of capital.

		(iv) custody services. as well as introducing new definitions for (v)derivatives and (vi) cryptocurrency activities.
	1B. Simplifying and harmonising the rules on proportional deduction	This consideration would simplify the rules on input tax deductions and harmonise their application. Three variants are considered, namely (i) simplification of the rules by making direct attribution the default for taxed transactions and the pro-rata method as the default for mixed inputs, (ii) application of a mandatory fixed rate of deduction, and (iii) application of an optional fixed rate of deduction. For variants (ii) and (iii), several approaches to calculating the fixed rate of deduction will be assessed.
2. Introduction of measures to reduce non-deductible VAT for the financial sector	2A. Review of VAT grouping and CSA	This consideration would introduce measures concerning the reduction of hidden-VAT on intra-group supplies, namely (i) extending the availability of VAT groups to the 6 MS where they are not currently allowed; (ii) extending VAT groups to include entities established in different MS, which is not currently the case; (iii) making CSAs available to providers of financial services in all MS and harmonise the rules for their use. This would be done by introducing several technical changes to the legal provisions on VAT groups and CSAs.
	2B. Mandatory option to tax for Member States	This consideration would require all MS to allow the option to tax for providers of financial services and to implement the option in a harmonised manner. Four variants are assessed, in terms of the scope of services covered and whether providers can exercise the option on a transaction-by-transaction basis or whether, once opting in, they must apply it to all eligible transactions.
3. Revisiting the VAT exemption for financial services and introduction of harmonisation measures in sectoral taxes	3A. Removal of the VAT exemption for all financial services 3B. Removal of the VAT exemption only for fee-based services	These considerations would remove the VAT exemption and apply VAT to either all financial services (3A), or only financial services remunerated by fees and commissions (3B). The considerations would be accompanied by a number of technical rules aimed at addressing practical challenges, such as how to define the taxable basis for interest-based services (for 3A) and how to deal with grey areas between interest- and fee-based services and mitigate risks of arbitrage (3B). The assessment examines several scenarios, namely (i) standard VAT rates and (ii) revenue-neutral rates. To avoid double-/over-taxation, the standard-rate variant will be tested alongside the removal of the sectoral taxes identified in the study, as well as in a basic variant where these taxes are retained. The analysis also considers carve-outs for basic banking services and pension funds.
	3C. Introduction of a Financial Activity Tax (FAT) for all financial services, with VAT zero-rating and removal of sectoral taxes	This consideration would zero-rate all financial services from a VAT perspective, allowing full-deduction rights, and replace the exemption scheme with an FAT levied on the sum of providers' profits and wages. To avoid double taxation, the sectoral taxes identified for the study would also be removed in the Member States where these currently apply. An additional complement includes the assessment of the elimination of transitional measures on the Capital Duty Directive; and the coordination by non-binding means (a Commission Recommendation) on sectoral taxes.

From a **legal perspective**, the incremental changes to the VAT exemption for financial services envisaged in Blocks 1 and 2 could be enacted through revisions to the relevant existing provisions of the VAT Directive, in particular the definitions of exempt financial services in Article 135, rules for VAT grouping in Article 11, rules for CSAs in Article 132, and the norms on option to tax in Article 137. In many cases, they could or should be accompanied by secondary legislation (e.g. to provide more clarity on the scope of the definition) or non-binding guidelines (e.g. on the more detailed requirements to participate in CSAs).

Revisions to the VAT Directive would also be sufficient for the more fundamental reforms to the VAT exemption envisaged in Block 3, that is the elimination or reduced scope of the exemption. However, this block also includes harmonisation measures for sectoral taxes, namely the removal of sectoral taxes such as IPTs, bank levies and payroll taxes that have been introduced in some Member States to offset the effects of the exemption. Given their similarity to VAT, in the case of IPTs, an amendment to Article 401 on other taxes, duties and charges, stipulating that IPTs are not permitted, would be sufficient to abolish these at EU level. For its part, the EU-wide FAT examined in Block 3 would need to be introduced through a dedicated legislative initiative.

Other sectoral taxes are firmly a national competence for which harmonisation through legislative means could be justified only on Single Market grounds. However, making this justification would not be clearcut, given the limited role of tax fragmentation as a barrier to cross-border trade compared to other factors, as discussed in Chapter 9 above[524]. Political feasibility would also present a significant challenge, with the targeted consultation showing near universal opposition to the harmonisation of sectoral taxes. Among tax authorities, this opposition was rooted in interpretations of Member States' right to levy taxes as a core area of national sovereignty. The announcement of the Commission in its 2026 Work Programme of the planned withdrawal of the 2013 proposal for an EU FTT, which comes at the end of long and unsuccessful negotiations in the Council, underscores the political difficulty of harmonising these areas of tax policy. For these reasons, policy considerations to harmonise sectoral taxes (other than IPTs) through legislative means are deemed unviable and not retained for in-depth analysis.

Instead, the **harmonisation of sectoral taxes other than IPTs, that would necessarily accompany certain policy considerations to remove the VAT exemption, would be achieved through soft law**. Specifically, a Commission Recommendation would be adopted to recommend the removal of tax measures, taking into account the tax burden depending on national specificities. The content of the Recommendation would depend on the specifics of the policy consideration in question, since these encompass a range of approaches to removing or part-removing the VAT exemption and the VAT rates to be applied. While in practice the Member States would retain full discretion over whether to implement the recommended changes to national sectoral taxes, for illustrative purposes the assessment of the impacts of the policy considerations under Block 3 (Chapter 14) assumes that this would be done.

11.2 Building block 1 - Modernisation and simplification of the current rules for VAT

This section focuses on **specific adjustments to the existing provisions of the VAT Directive which do not aim at reducing hidden VAT.** These could be pursued to improve the situation if the current exemption were to be fully or partly retained.

As a starting point, the issues identified in the legal analysis are broadly in line with those that emerged in the previous study, meaning that the considerations presented below are similar to the ones considered at that time, which themselves bear some similarities to those analysed in the 2007 Impact Assessment[525].

[524] The fact that such a justification has not been made for fiscal factors, such as varying CIT rates, that *in primus* are more relevant to the level playing field in the Single Market, demonstrates the likely difficulty of this approach.

[525] Proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax, as regards the treatment of insurance and financial services {SEC(2007) 1554} {SEC(2007) 1555}, /* COM/2007/0747 final - CNS 2007/0267 */

11.2.1 Policy Consideration 1A – Modernisation of the definitions of the VAT exemption.

Under Consideration 1A, a number of definitions could be revised or further detailed, by means of non-binding guidelines or a secondary legal act. Adopting a binding or non-binding act could represent different sub-considerations, to be analysed separately.

The attempt to modernise the definitions of financial services was one of the main aims of the 2007 legislative proposal, which proposed to draft lists of services excluded (blacklists) or covered (whitelists) by the exemption in a secondary legal act. Negotiations in the Council progressed significantly in this area; once refined, considering the intervening case law and the evolution of business since that time, this work represents a solid basis to further develop this policy consideration.

The consideration would concern the introduction of new definitions (in Article 135) to account for digital financial services and other financial services which are currently not explicitly mentioned in the Directive (e.g. derivative transactions). It would also address discrepancies in two broad areas, namely insurance-related services, and the management of investment funds and related asset management activities to ensure funds keep up with digitalisation and changing investor preferences, so that they in turn remain competitive going forward. The differences in the VAT treatment of pension funds and the Pan European Pension Product (PEPP) would also be considered, given their importance from a SIU perspective.

Based on the analysis provided in Section 3.1, the previous study and the 2007 legislative proposal[526], the following definitions have been identified as problematic, because of being insufficiently clear, outdated, or implemented unevenly across the Member States.

- **Derivatives.** The study highlights some divergence across Member States in the VAT treatment of derivative transactions with a physical underlying. In particular, in some Member States, derivatives linked to physical goods can be considered taxable, unlike derivatives with a financial underlying. The treatment is clearer for derivate contracts providing for delivery that are ultimately cash-settled (i.e., no delivery takes place). Aligning the treatment of derivatives with a physical underlying to that of financial derivatives would address these issues. Under this approach, derivatives would be exempt, while any physical delivery would be taxed as a separate transaction.
- **Management of certain collective investment funds, including pension funds**. In this area, the main issues stem from the divergent Member State interpretations of what constitutes a "special" collective investment fund. These differences directly affect the scope of the VAT exemption for fund and asset management activities, which only covers such activities when the underlying fund is exempt. Two approaches will be considered. The first would consolidate the Court of Justice's existing case law, possibly by means of non-binding guidelines, by clarifying that the exemption covers UCITS, non-UCITS funds equivalent to UCITS, and defined-contribution pension funds, including Pan European Pension Products. The second approach would depart from current CJEU interpretations and would hence require a legislative intervention. Drawing on the 2007 Proposal, this would involve extending the exemption to all pension funds, irrespective of their structure and including Pan European Pension Products, in addition to UCITS and UCITS-equivalent funds.
- **Supporting payment services.** Greater precision is required as regards the scope of the exemption of supporting payment services. This would reflect structural changes in the payments market, notably the growing role of IT service providers and alternative intermediaries in processes previously conducted internally within financial institutions. Drawing on the balanced framework set out in the 2007 legislative proposal and subsequent Council negotiations, a modernised approach would exempt "financial transfers", covering the execution of various forms of money transfers, while excluding ancillary services such as safekeeping of money, message transmission, and the provision of transfer-related information. It would also include within the exemption outsourced services involved in payment authorisation and verification, as they go beyond the mere

[526] Proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax, as regards the treatment of insurance and financial services {SEC(2007) 1554} {SEC(2007) 1555}, /* COM/2007/0747 final - CNS 2007/0267 */

transport of messages, since the provider assumes responsibility for the validity of the payment data. By contrast, purely technical services would remain outside the exemption.

- **Intermediation and insurance-related services**. Two changes are envisaged to clarify the definitions for these services. First, the term "intermediation" would replace the term "negotiation"; the definition of "negotiation" would in turn capture the current distribution models within the exemption, including both intermediaries and sub-intermediaries. This would reduce uncertainty where the application of the exemption currently depends on contractual structures, remuneration models, or the legal status of intermediaries. A second intervention would be to align the VAT treatment of financial and insurance intermediation by applying the same rules to both sectors. This would remove the existing distinction between financial intermediaries and insurance agents or brokers. The exemption should not be linked to the nature of the supplier but be extended to all services which are a constituent element of an insurance service, in line with the current case law. This definition would be coupled with a list specific insurance-related services to which the exemption should or should not apply.[527]
- **Custody services**. The VAT treatment of custody services provided by global custodians currently varies across the Single Market in two key respects. First, some Member States treat bundled custody services as a single exempt supply. Second, there is divergence as to whether taxation applies only to physical safekeeping or also to electronic safekeeping, such as e-custody services with respect to cryptocurrencies. A possible revision, possible with non-binding guidelines, would align national practices with the Court of Justice's interpretation by treating safekeeping services as a distinct taxable supply and that cannot be regarded as ancillary to exempt custody-related services. A different approach, which would require a legislative revision, would– in line with the original spirit of the Directive and CJEU jurisprudence[528] – tax both physical and electronic safekeeping and custody services.

Table 45 below summarises the proposed changes to the current definitions, explaining in which cases these result in a broader or narrower exemption, and whether the changes apply to the whole of the EU or only to some Member States.

Table 45. Summary of proposed changes to current definitions

Supply	Proposed changes	Effect on the exemption
Derivatives	Align treatment of derivatives with physical and financial underlying	Broader in some MS
Management of collective investment funds	Consolidating current interpretation (UCITS + UCITS equivalent + defined contribution pension funds)	Stricter in some MS
	Covering all pension funds	Broader in some MS
Payment supporting services	Include authentication and verification of payments	Broader
Intermediation and other outsourced insurance services	Change 'negotiation' in the place of 'intermediation', explicitly include sub-intermediaries, eliminate differences between financial and insurance service markets	Limited
	Eliminate differences between financial and insurance markets, de-linking the exemption with the nature of the supplier ('insurance agent or broker')	Broader in some MS

[527] For, instance In line with the 2007 proposal, claims handling could be considered exempt, regardless of by whom this service is carried out. On the contrary, damage assessment and the provision of in-kind goods and services by the insurer to the insured party as compensation for the loss suffered could fall outside of the scope of the exemption.

[528] Judgment of the Court of 4 May 2006, *Abbey National plc and Inscape Investment Fund v Commissioners of Customs & Excise*, C 169/04, EU:C:2006:289.

Custody services	Clarify that safe custody is not ancillary to exempt custodian services	Stricter in some MS.
	Clarify that both physical and electronic custody services are assimilated to safekeeping and hence taxable	Broader

The revisions to the Directive would also include **specific treatment for cryptocurrency activities and services**, by means of a binding intervention (either in the Directive or in the Implementing Regulation). In general, cryptocurrencies would be treated as 'currency', provided that they can be exchanged bidirectionally (i.e. from fiat into crypto currencies and vice versa). In other words, transactions paid in cryptocurrencies would be treated as transaction in a foreign currency, and not as barter transactions The proposed definitions are based on the most common approach adopted by the Member States, the CJEU jurisprudence, and the work of the VAT Committee, as summarised in Table 46.

Table 46. Definition of innovative services

Supply	Proposed VAT treatment
Exchange of cryptocurrency into / from fiat currency	Exempt, based on Article 135(1)(e)
Digital wallets, custody services	Exempt, based on Article 135(1)(d); to be linked to the revision of custody services
Mining and forging for own use	Out of scope
Mining and forging for third parties	Taxable
DeFi services (decentralised crypto exchanges, liquidity / lending pool operators, staking intermediation services)	Exempt, based on a revised definition of 'negotiation' which should include also automated negotiations via e.g. smart contracts and protocols
Sales of NFTs, crypto-art	Taxable

Any revision of the definitions – especially to the extent to which they would diverge from the current interpretation of the Directive by the CJEU and in the Member States – could alter the scope of the exemption and thus have impacts on VAT revenue and business models. However, such impacts were deemed likely to be minimal in the previous study and the same reasoning would still hold true. Rather, the key objectives pursued by such a review would consist in **increasing legal certainty and reducing fragmentation in the Single Market** by harmonising national interpretations.

11.2.2 Policy Consideration 1B - Simplifying and harmonising the rules on proportional deduction

Harmonising and simplifying the rules on proportional deduction can serve different purposes. First and foremost, this would be **an administrative simplification** for financial service providers, providing clearer rules. Secondly, it would reduce discrepancies between Member States, thus **making for a less uneven playing field**, eliminating the currently diverging national approaches. Finally, depending on how the system is framed, the new rules can **reduce or eliminate the input distortions** due to the exemption, favouring the acquisition of supplies, particularly IT, from third party suppliers.

In these respects, three variants will be explored:

- **Simplification of the current rules (variant i)**. The current approach to proportional deduction would not be altered, but it would be simplified by setting the direct attribution method for inputs used for taxed transactions and setting the pro-rata method as the default method for mixed inputs.
- **Fixed rate of deduction,** which could be made either **mandatory** or **optional (variants ii and iii, respectively).** All providers of insurance and financial services should (mandatory fixed rate) or can (optional fixed rate) deduct a fixed amount of input VAT. Under the optional regime, providers could opt-out of the fixed rate and perform the detailed pro rata calculations to apply the 'real' deduction percentage.

The introduction of a fixed rate of deduction requires further specification in four key elements: (i) the scope of the provision; (ii) the activities covered; (iii) the VAT deduction rate; and (iv) the geographical scope.

Scope of the provision. Two variants are possible and will be assessed. Under the first, a fixed deduction rate would apply to all inputs, eliminating the distinction between inputs used for taxed/zero-rated transactions and those used for exempt transactions. Under the second, the fixed rate would apply only to VAT incurred on "mixed inputs." The first approach will be retained for the analysis, since it offers the greatest potential for simplification and harmonisation.

Businesses covered. For analytical purpose, it is assumed that the reform would only apply to suppliers of financial services, i.e. to suppliers of any service exempt based on Article 135(1)(a-g), despite, in principle, a similar reform could be introduced for providers of other types of exempt services outside the financial sector.

Deduction rate. One variant to be assessed would reflect the current average VAT deduction level in the three sectors under review (banking activities, asset management and insurance undertakings)[529], so that the mandatory fixed rate is, in aggregate, revenue neutral (although individual firms may be affected differently). Another variant to be assessed would provide for a deduction rate higher than the current deduction level (cd. 'super-deduction'), to reduce the distortions against outsourcing.

An optional fixed rate set equal to current average rates would not be revenue-neutral, as businesses would naturally only take up the option in cases where it would be advantageous for them, thereby raising the average deduction. To address this, the analysis assumes a fixed rate set at 80% of the previous average rates. In practice, the rate would need to be calculated by Member State tax authorities using VAT declaration data over several years, and update periodically. For the purpose of the analysis, appropriate rates will be determined using the study team's economic model. The methodology for the calculation of the different deduction rates is further elaborated in section 12.2.2.

Geographical scope. Deduction rates could be set at EU or national level. A single EU-wide rate would maximise harmonisation, while national rates would better reflect local market structures; both approaches would be considered.

11.3 Building block 2 - Introduction of measures to reduce non-deductible VAT for the financial sector

This section focuses on **specific adjustments to the existing provisions of the VAT aimed at reducing hidden VAT**. As with those foreseen under block 1, these could be pursued to improve the situation if the exemption were to be retained. These options will (partly) tackle the hidden VAT problem, reducing its impact on the price of financial services and facilitating the outsourcing of certain input supplies. At the same time, by reducing hidden VAT, they would result in tax revenue losses.

11.3.1 Policy Consideration 2A – Review of VAT grouping and CSAs

In this area, the analysis explore extension of and changes to VAT grouping, as well as the re-introduction of CSAs. These two VAT systems are assessed together, for three reasons: (1) they fulfil a similar scope, reducing hidden VAT (exclusively or mostly) on intra-group supplies; (2) in many countries, they are perceived and used interchangeably by stakeholders, so that several tax authorities have introduced VAT grouping following the elimination of CSAs; (3) their effects can be assessed and modelled similarly.

The dynamic baseline scenario entails the progressive removal of CSAs in the six Member States where they are still available, resulting in the elimination of their use in the financial sector throughout the EU. In other words, it gives full effect to the 2017 CJEU judgments which held that CSAs could not be used by financial service providers.

Against the dynamic baseline scenario, three variants are to be assessed:

- **2A(i): Mandatory introduction of VAT grouping in all Member States**

[529] More granular sub-sectoral rates could be envisaged, but current data availability does not allow their analysis.

- **2A(ii): Introduction of cross-border VAT grouping**
- **2A(iii): Re-introduction of CSAs.**

Under the first consideration, Article 11 of the VAT Directive will be revised by **making VAT groups mandatory in all Member States**. This would reduce hidden VAT, and hence VAT revenues, in the five Member States[530] which currently do not have them, with both effects assessed quantitatively.

Under Article 11 of the VAT Directive, it is required that members of a VAT group must be established in the territory of the Member State in which the VAT group is created. The effect is to limit members of the VAT group to those companies which are established in that Member State.[531] Under the second consideration, the possibility to relax this constraint and **allow entities established in different Member States to be part of the same VAT group will be assessed**, along with the associated challenges and practical solutions.

In principle, it would be possible to include in the same VAT group entities established in different Member States and closely bound to one another by financial, economic and organisational links. However, this would present significant challenges concerning revenue shifting tax avoidance and coordination with the broader VAT framework, including:

1. **Economic, financial and organisational links.** Harmonisation of the notions of 'financial, economic and organisational links' across all EU Member States will be required to ensure that the same criteria are applied by all Member States to VAT group membership.
2. **VAT due and VAT deduction.** If entities belonging to the group lost their 'VAT personality' and their VAT registration, they should handle local VAT due or deductible differently (e.g. via VAT registration). Depending on a number of factors (e.g. the involvement of a fixed establishment the place of supply of the transaction), there may be shifts in VAT revenues across Member States.
3. **Cross-border controls**. To verify that VAT is accounted properly, Member States in which the cross-border VAT group is established should be able to control or have oversight of the activities of the group member established in a different Member States, which is more challenging compared to controlling domestic entities. An automatic data exchange system should be established to this purpose.
4. **Reporting**. Intra-group supplies would become out of scope of VAT, and hence would not need to be reported, invoiced or included in VAT returns. However, existing statistical reporting mechanisms may have to be kept (for supplies of goods). The interaction between ViDA requirements for the reporting of intra-EU supplies should be coordinated with the new rules.
5. **Cross-border VAT groups.** In domestic VAT groups, group members cannot reclaim VAT incurred in another Member State via the refund procedure. In a cross-border setting, the VAT group established in e.g. France may have to reclaim VAT incurred in e.g. Italy by an entity established in Germany, a situation which is currently not supported by the refund system.
6. **Partial deduction**. A VAT group may have the same *pro rata* or, in countries which so allow, may calculate different *pro rata* for various activities or entities. In the former case, the country in which the group member is established should be informed (and have the means to verify) the *pro rata* at group level. There could also be an incentive to establish the group in countries with a more favourable treatment of proportional deduction, to increase *pro rata*.

Yet expertise could be drawn from the application of the UK VAT grouping rules and relevant anti-avoidance measures put in practice.

Finally, **the last consideration foresees the re-introduction of CSAs for providers of financial services**. For the Member States that previously allowed CSAs, large corporate groups were able to use these to provide centralised services both within and between Member States, thereby reducing hidden VAT. However, these are being phased out and are currently only available for financial service providers in six Member States. To compensate for the lack of CSAs, VAT groups have been progressively introduced in

[530] Bulgaria, Greece, Croatia, Lithuania, Romania.

[531] The VAT group can also include established branches of companies which are themselves not established in the Member State in which the VAT group is created.

more and more Member States (21 at the time of writing), but these can only be used domestically (members of the group must be established in the Member State in which the VAT group is created), a key weakness according to many multi-national financial institutions.

Under this consideration, CSAs would be made available to providers of financial and insurance services in all EU Member States. This requires clarifying several detailed aspects, such as:

1. **Cross-border use**: whether the group and its members must be established in the same Member State, in any EU Member State, or may also include entities in third countries (and hence whether the CSA can provide exempt services to members established in a different Member State or in a third country).
2. **Supplies to non-members**: whether the group may provide taxed supplies to entities outside the group.
3. **Members' activities**: whether members must exclusively or predominantly carry out exempt or out-of-scope transactions.
4. **General services**: whether services of a general nature should be excluded.
5. **Interaction with VAT groups**: whether VAT groups may be members of CSAs.

Table 47 below describes the suggested approach. It largely consolidates the approach suggested by the VAT Committee and the Member States' practice. The most relevant aspect concerns cross-border usage: allowing CSAs to be used across EU Member States seems the best approach and in line with the VAT Committee opinion[532], also considering that, under the current rules, VAT groups do not work cross-border. Limiting CSAs to domestic settings would also run contrary to the spirit of the EU Savings and Investment Union, which calls for closer integration of banking and financial markets, whereby cross-border financial groups can play a facilitating role. In contrast, it is suggested not to allow for the participation of non-EU entities that are not established in the EU, as it would be difficult (or impossible) to verify whether non-EU entities respect the CSA criteria.[533]

Table 47. Policy consideration 2A(iii): Re-introduction of Cost-Sharing Arrangements

Cross-border usage	The group and its members can be based in any Member State
Supplies to non-members	The group can provide taxed supplies to non-members
Activities carried out by members	Members can carry out taxed activities; exempt or out-of-scope activities must represent the majority of economic activity
Services of a general nature	The services provided by the group to the members to be 'directly necessary' for the provision of exempt services; services of a general nature cannot benefit from the exemption. This provision was in force in most MSs allowing CSAs; however, it may lead to significant complexities and national divergences. If adopted, a black-list of excluded services is to be included in a secondary act or explanatory notes[534]
Interaction with VAT groups	VAT groups can be members of a CSAs

[532] VAT Committee Working Paper No 856, 6 May 2015, TAXUD.C.1(2015)2162037 and VAT Committee Working Paper No 883, 30 September 2015, taxud.c.1(2015)4500631.

[533] Alternatively, participation of non-EU entities could not be allowed unless adequate instruments of administrative cooperation in tax matters – equivalent to those applicable within the EU – are in place between the third country concerned and the relevant Member State(s), on the basis of reciprocity, allowing for the effective verification of whether those entities respect the CSA criteria.

[534] See also the CJEU interpretation of this requirement in Judgment of the Court of 22 January 2026. *Agrupació de Neteja Sanitària, AIE and Educat Serveis Auxiliars SCCL v Tribunal Económico-Administrativo Regional de Cataluña (TEARC)*, Joined Cases C-379/24 and C-380/24.; ECLI:EU:C:2026:29.

Interaction with transfer pricing rules	An exception should be made to transfer pricing rules (which presuppose a cost mark-up), or the mark-up should be included in among the costs apportioned to members

11.3.2 Policy Consideration 2B - Mandatory option to tax for Member States

Under this consideration, Article 137 should be reviewed by making it available to all suppliers of financial services, i.e., removing the Member States' discretion on whether to introduce it. Different variants have been identified for testing depending on their scope or implementation modality, which would have an impact on the uptake and revenue effects will be tested, in particular:

- the scope, i.e. whether it should be available for all financial services, including insurance services (which are currently excluded); and
- whether it should be exercised at entity level or on a transaction-by-transaction basis. A transactional option to tax would allow a near-perfect market discrimination, with VAT imposed only on business customers with the right to deduct; an entity-level option to tax would not allow a granular discrimination and would likely lead to the creation of dedicated entities serving the B2B segment, and / or limited uptake of the option.

Other aspects of the regime (e.g. how to apply / register for use of the option, whether the option should be applied mandatorily for a number of years) could be harmonised or left at Member States' discretion, but in any case would have a limited effect on the impacts.

Finally, it should be clarified that the option to tax could be used also for cross-border transactions. To accommodate for this change, the place of supply rules should be shifted to the country of destination (i.e. customers' residence or establishment), and the practical consequences from such change should be considered, including the use of the One-Stop-Shop (OSS) to remit VAT on qualifying B2C supplies and mandatory reverse charge for B2B supplies.

11.4 Building block 3 - Revisiting the VAT exemption for financial services and introducing harmonisation measures in sectoral taxes

This block focuses on fundamental reforms, namely the removal (in full or in part) of the VAT exemption, together with potential changes to related sectoral taxes. These considerations would aim to reduce the discrepancies, complexity, uncertainty, distortions and administrative burdens related to the VAT exemption, while increasing the scope of service providers to deduct input VAT.

11.4.1 Policy Considerations 3A and 3B – Removal of the VAT exemption for all or only for fee-based financial services

➢ *Overview*

These considerations entail the removal of the VAT exemption for all financial services (3A) or only for fee-based services (3B). Depending on the VAT rates applied (see discussion below), variants of these considerations include the removal of sectoral taxes (see discussion below under practicalities). As explained above, while an amendment to the VAT Directive (Article 401) would be sufficient to remove IPTs, the removal of other sectoral taxes would be effected through a Commission Recommendation on action at national level.

➢ *Scope of services to be taxed*

Several of the problems identified relate to the existence of the exemption. Therefore, the most *conceptually* simple and purest approach would be **Consideration 3A, to remove the exemption entirely**. This would entail applying VAT to all financial services, and thereby lead to a broad-based taxation of the financial sector. This would bring financial services into line with the general VAT rules, fully restoring

VAT neutrality and eliminating the need for complex arrangements regarding such aspects as service definitions and proportional deductions. This is already possible to a certain extent in four Member States[535], given their approaches to the option to tax. That said, taxing (applying VAT to) credit would also bring significant implications for monetary policy and interest rates, as well as practical challenges, meriting extremely careful consideration (as discussed below).

Alternatively, **Consideration 3B would remove the VAT exemption for fee-based** services only. More specifically, it would tax services remunerated by means of a fee or commission, such as credit card fees, account management fees, commissions for the issuance or sale of securities, insurance intermediary commissions, insurance brokerage fees. This would be in line with the approaches observed in most of the third countries examined for the study (see Section 3.2), while avoiding the practical challenges of determining the appropriate consideration on interest rates and potential implications for monetary policy[536].

- ***Practical considerations***

The analysis considers variants with different VAT rates, namely (i) standard rates; and (ii) revenue neutral rates[537] determined using the study's partial-equilibrium model With regard to sectoral taxes, the standard VAT rate variants are both tested in scenarios where these are removed (fully in the case of 3A(i), and for the revenue associated with fee-based services for 3B(i)) and – for comparison purposes – retained[538]. The possibility of retaining the VAT exemption for certain essential services, like basic banking services[539] and pension funds, is also considered.

From an **analytical perspective**, all output in the financial sector is defined as fee-based except the net-interest income of banks, data on which has been provided by EBA.

Given the complexity of the financial sector, several issues need to be considered in order to assess and implement in practice any policy change that involves removing / partially removing the VAT exemption. The most important of these are discussed below, with inspiration drawn inter alia from the examination of third countries applying VAT to financial services (see Section 3.2):

- **Taxing interest-based services**: for Consideration 3A, a key practical challenge is to determine the tax base for interest-based services. Several approaches have been developed, in some cases, tested, all of which have pros and cons (as described in Box 17 below). For the purpose of the analysis, three ways of defining the tax base are tested, namely:
- **Gross interest**: this is the approach taken in China and (under its option-to-tax regime) Germany, which entails applying VAT to the gross interest charged by banks to their customers. However,

[535] I.e. Estonia, Germany, Lithuania and Poland.

[536] From a practical perspective, the assessment excludes life insurance, since this would introduce a distortion compared to other (untaxed) forms of investment as well as creating practical difficulties.

[537] The rates were determined using the study team's partial equilibrium model; see overview of the methodology in PART C introduction below.

[538] Regarding the removal of sectoral taxes, for the purpose of the economic modelling for the study (see methodology under Part C below), these encompass all of the taxes identified - taxes on the sale of financial services products (including IPTs), FTTs, financial institution levies, payroll taxes, additional CIT and windfall taxes. The rationale for removing all rather than only some of these taxes is as follows. First, most of the tax revenues identified come from taxes that were introduced in part or full to offset the effects of the VAT exemption; this includes IPTs, financial institution levies and payroll taxes. A similar reasoning applies to several of the other taxes accounting for the remaining revenues, such as stamp duties and additional CIT. This leaves a relatively small group of taxes for which inclusion or exclusion could reasonably be debated. However, for the sake of transparency and simplicity, these taxes are removed as well, rather than retained or removed based on subjective judgements. At the same time, as discussed in Part C, were the exemption to be removed in reality, the actual taxes to be removed would depend on the decisions of individual Member States.

[539] For the sake of the study, basic payment services are defined as payment accounts with basic features, as per Directive 2014/92/EU of the European Parliament and of the Council of 23 July 2014 on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features (Text with EEA relevance).

while relatively simple, this means that, as a nominal interest rate, the taxable basis includes inflation as well as risk[540][541].

- **Interest-margin minus average loss provision**: to avoid taxing risk, VAT could be applied to the net interest margin[542] minus the average loan loss provision of the previous few years. A complication of this approach is that it requires proxies for the net interest margin and the average loss provision to be estimated, which would in turn be used to estimate the taxable amount and VAT due on each transaction.
- **Net revenues**: this approach, introduced in Brazil in 2026, taxes net revenue[543] over a time period. While relatively straightforward, its disadvantage is that, by dodging the challenge of applying VAT to individual transactions, it is more similar to the FAT discussed under consideration 3C. To account for these issues, three taxable bases will be tested: (i) gross interest; (ii) interest margin minus average loss provision; and (iii) net revenues.

  In addition, when it comes to interest paid to consumers on deposits, this will remain outside the scope of VAT, as is indeed the case in all jurisdictions examined for the study.

Box 17. Literature on the taxation of interest-based services

➢ ***Cash-flow methods***

The **cash-flow method** is a conceptually pure solution developed by Hoffman, Poddar and Whalley (1987)[544] and explained in seminal work by Poddar and English (1997)[545]. It extends the invoice-credit VAT to financial intermediation by taxing all cash flows into a financial institution as taxable outputs and treating all cash outflows as input purchases with credit[546]. In its most basic form, the cash flow model is based on measuring the total cash inflows and outflows (capital and revenue) associated with financial transactions[547].

In a nutshell, under the cash-flow method, any outflow of money from financial institutions would be considered as a taxable input supply, and any inflow of money to financial institutions as a taxable output supply. Hence, the taxable basis would include not only the interest on credit, but also the principal. For instance, when taking a loan of EUR

[540] The interest rate can be said to be composed of three components, namely (i) the risk-free interest rate, which reflects the neutral market-based interest rate for debt; (ii) the default risk, i.e. the compensation for the fact that a certain volume of loans will not be repaid; and (iii) the commercial spread, which is the mark-up made by the lender. In principle, only the latter consists of 'value added' and should form the VAT basis for.

[541] Copenhagen Economics (2016)Why and how to apply a Value Added Tax on financial services, Report for a private client.

[542] There are two possible approaches to the definition of the net interest margin. A more theoretical approach would define it as the lending rate minus the loan-free risk provision. The latter can be hard to determine for fiscal purposes but would allow for calculating the tax on a transaction-by-transaction basis. Another approach would be to use the accounting standards and calculate net margin as interest received on loans minus interest paid on deposits (and other interest-bearing liabilities). This is a close approximation of the added value, but those variables are calculated by banks in aggregate. In other words, it is not possible to link a specific input – the deposit – to a specific output – the loan. They would thus be compatible if VAT were applied to the financial services provider's added value – similarly to a FAT – or if the net interest margin were calculated for each transaction based on previous years' values, and then adjusted ad the end of the year (as it is the case, e.g., for *pro rata* calculations).

[543] In Brazil, a 'subtraction approach' is adopted similar to the one in place with the current turnover taxes. Taxation of interest-based services follows an account-based method: the VAT basis consists of the difference between revenues and deductible expenses related to the financial services (e.g. financial expenses incurred as cost of funding, foreign exchange expenses, losses on securities and financial instruments). Cf. Melina Rocha, Daniel Loria (2025) Broadening the VAT Base: Financial Services and Supplies of Real Property in the Brazilian Tax Reform, Kluwer Tax Blog.

[544] Hoffman, L.A., Poddar, S. and Whalley, J (1987). "Taxation of Banking Services under a Consumption Type, Destination Basis VAT." National Tax Journal 40 (4), 547– 554.

[545] Poddar, S., & English, M. (1997). Taxation of Financial Services under a Value-Added Tax: Applying the Cash-Flow Approach. National Tax Journal, 50(1), 89–111.

[546] Adam, S., Besley, T., Blundell, R., Bond, S., Chote, R., Gammie, M., ... & Poterba, J. (2010). Dimensions of tax design. Oxford.

[547] Kerrigan, A. (2014). Effects of VAT on financial services. In *Taxing Banks Fairly* (pp. 127-155). Edward Elgar Publishing.

100, a business customer would receive EUR 100 and pay EUR 20 of VAT (assuming a 20% rate); the bank/lender would get a EUR 20 VAT credit. When repaying the loan (e.g., the subsequent year at a 10% interest rate), the company would pay EUR 100 for the principal and EUR 10 for interest, and receive a VAT credit of EUR 22; the bank would receive EUR 110, and would pay EUR 22 in VAT. Summing up, the net VAT paid is EUR 2, which is equivalent to charging VAT on the interest element only. From a *theoretical* perspective (Crawford, I., Keen, M., & Smith, S.)[548] it replicates exactly the effect of VAT. However, despite its theoretical appeal, the cash-flow VAT has long been deemed impractical by Zee (2005)[549] to implement on a broad scale. By taxing the principal, it adds enormously to the cost of credit: a company/consumer would need to pay 20% VAT upfront on the funds received from the bank (i.e., the loan) and could only recoup it over the following years. In addition, in any year in which outflows (e.g., loans) or inflows (e.g., deposits and/or loan repayments) are not equal, the bank would need to pay significant amounts of VAT or benefit from large VAT credits, with possible liquidity problems for financial institutions or public budgets.

The **truncated cash-flow method (Tax Calculation Account - TCA)** tried to avoid taxing large principal flows up front, while still achieving the present-value equivalence of the full cash-flow method[550] Rather than levying VAT immediately on e.g., a loan disbursement and an equal credit on repayment, the bank maintains a suspended account (the TCA) for each customer or account where those tax amounts are recorded but not actually paid to the authorities until a later offsetting transaction occurs. In practical terms, when a loan is issued, the VAT that would have been due (if it were treated as a sale) is deferred by recording it in the TCA. When the interest and principal are later received from the borrower, a portion of those inflows is applied to clear the TCA entry (i.e. the tax is now actually remitted). Similarly, for depositors, VAT on the initial deposit (treated as a purchase by the bank) is not immediately refunded but held in the account until the depositor withdraws funds or interest is paid, and then offsets are made. By carrying principal-related tax forward with an appropriate accrued interest, the TCA method ensures that, ultimately, the tax paid equals what a full cash-flow VAT would have yielded, but gross tax flows are greatly reduced in the interim. Essentially, the TCA approach taxes only the net interest margin, i.e. the difference between interests received and paid in real time, while tracking the principal-related tax internally until loan maturity or deposit withdrawal.

- ***Account based methods***

According to Gendron[551] three methods can be classified as account-based to calculate VAT: the subtraction method, the addition method, and the net operating income method. The latter, developed by Bakker and Chronican (1985)[552], takes the net operating income - defined as net interest margin (interests received minus interests paid) plus, trading margins, fees, and explicit commissions, as a tax base. The **subtraction method** by Bird and Gendron (2007) [553] calculates value added as the differential between aggregate revenues and deductible purchases. The **addition method** determines value added by summing wages, cost of capital, and net profits. This method is frequently cited as a straightforward solution (Bird and Gendron, 2005)[554]. However, the incompatibility of all three methods with the credit-invoice system means that registered entities are unable to recover input VAT paid on purchases. If these methods are not applied consistently across all goods and services, market distortions will be inevitable and irrecoverable input VAT will remain.

- ***Methods for taxing interest margins***

The interest margin method consists of identifying the portion of interest rates that represents the value of financial intermediation and taxing that portion as the service fee. Often termed margin-based or net interest methods, these seek to tax the interest spread (the difference between what a bank charges borrowers and pays depositors) as the taxable base.

[548] Crawford, I., Keen, M., & Smith, S. (2010). Value added tax and excises. Dimensions of tax design: the Mirrlees review, 1, 275-362.

[549] Zee, H. H. (2005). A New Approach to Taxing Financial Intermediation Services Under a Value–Added Tax. *National Tax Journal*, *58*(1), 77-92.

[550] Poddar, S., & English, M. (1997). Taxation of Financial Services under a Value-Added Tax: Applying the Cash-Flow Approach. National Tax Journal, 50(1), 89–111; Cf also Edgar, T. (2001). "Exempt Treatment of Financial Intermediation Services under a Value-Added Tax: An Assessment of Alternatives." Canadian Tax Journal 49 (5), 1133–1219.

[551] Gendron, Pierre-Pascal(2008). VAT Treatment of Financial Services: Assessment and Policy Proposal for Developing Countries, Bulletin for International Taxation 62 (11), 494– 507.

[552] Bakker, Carl, and Phil Chronican(1985), Financial Services and the GST: A Discussion Paper. Victoria University Press for the Institute for Policy Studies, Victoria University of Wellington, Wellington, NZ.

[553] Bird, R. M., & Gendron, P. P. (2007). The VAT in developing and transitional countries (Vol. 207). Cambridge University Press.

[554] *Ibidem*.

This can be done by adjusting interest flows rather than principal flows. For example, one proposal is a **reverse charging mechanism** by Zee (2005)[555]: the bank's interest receipts from loans would be treated as taxable outputs, while interest payments to depositors are treated as purchases attracting input VAT credit. The bank would then remit VAT on the net interest margin (output tax on loan interest minus input tax on deposit interest), effectively achieving the same result as the cash-flow method but without taxing principal amounts. Taxing interest margins in this way requires a method to split each interest flow into an "interest service" component versus a pure cost-of-funds component.

Another concrete implementation is the **"separate rate" method** developed by Bakker & Chronican (1985)[556]. Under this method, a notional rate or proportion of each interest transaction is deemed to be the service fee. For instance, if normal funding costs are estimated at 5%, a loan at 9% interest contains a 4% value-added component that would be taxed. Each category of financial transaction (loans, deposits, etc.) could have an assigned taxable percentage representing the intermediary's margin on that product. In practice, setting these percentages would rely on industry data or regulatory benchmarks for "normal" interest.

Bird and Gendron (2005)[557] outlined a variant for developing countries: tax explicit fees and commissions normally under VAT, and tax the implicit margin on interest-bearing services using an approximate ratio method. They note that by taxing all explicit fees plus an approximation of the financial margin, nearly all consumption of financial services can be brought into the tax base. This hybrid approach was seen as relatively simple and practical while preserving key advantages: it taxes almost the entire value added of financial services, maintains compatibility with the invoice-credit VAT system (since each interest charge is partly treated as a taxable service), and grants full input VAT credit to financial institutions, thereby avoiding cascade effects.

- ***"Mobile-ratio" method***

Presented by López-Laborda and Peña (2018)[558] the **mobile-ratio method** uses aggregate information about a financial institution's value added to dynamically allocate the taxable base across its financial transactions. In essence, the mobile-ratio method periodically computes the ratio of the firm's value added to its total financial flows and applies that ratio to each financial transaction to determine the taxable portion. For example, if a bank's accounts show that 30% of its gross interest income (after paying interest to depositors and other inputs) is value added (wages + profits), then roughly 30% of each interest payment received could be treated as the taxable service fee. This ratio is updated regularly (e.g. quarterly) to reflect current margins, hence "mobile-ratio." By doing so, the method obtains near-complete taxation of the value added by financial services providers while using information readily available from financial accounts. All explicit fee income would still be taxed normally at 100%, and the ratio is applied mainly to interest spreads and other implicit charges. Importantly, the mobile-ratio approach remains within the invoice-credit mechanism: banks would charge VAT on the calculated taxable portion of interest charges to customers, who if taxable businesses could credit it. Thus, it promises full input credit for business use (no cascading) and the taxation of virtually all final consumer financial consumption.

- **Implications for the cost of credit and monetary policy**: regardless of the practical considerations, applying VAT to interest-based services could have implications on the cost of credit and monetary policy. The impacts on the potential distortion in prices and the transmission of interest rates across countries are discussed in more detail in Section 14.2.5 together with the assessment of consideration 3A.
- **Definition of services remunerated via on fees and commissions**: Consideration 3B requires the services covered to be legally defined. This starts from considering the introduction of a general provision for which all financial services remunerated via fees, commissions, or equivalent considerations are taxed. A priori, any price which does not consist of an interest rate (or spread thereupon) can be considered a fee. This includes both explicitly defined fees charged by the financial or insurance company to the customer, as well as implicit fees – typically referred to as 'commissions' – that are normally not directly paid by the customer but paid back by the service

[555] Zee, H. H. (2005). A New Approach to Taxing Financial Intermediation Services Under a Value–Added Tax. National Tax Journal, 58(1), 77-92.

[556] Bakker, C. and Chronican, P. (1985): Financial Services and the GST: A Discussion Paper, Wellington: Victoria University Press for the Institute for Policy Studies.

[557] Bird, R., Gendron, P. P., & Rotman, J. L. (2005). VAT revisited. A new look at the value added tax in developing and transitional countries. In USAID Workshop for Practitioner on Tax (Vol. 4).

[558] López-Laborda, J., & Peña, G. (2018). A new method for applying VAT to financial services. National Tax Journal, 71(1), 155-182.

provider to their intermediaries. Fees can be expressed either in EUR (e.g., EUR per type of operation, such as in the case of credit cards annual fees for customers or fixed merchant fees) or as a fraction of the value of the underlying transaction (e.g. as a fraction of the payment amount for bank transfers, or of the assets under management for investment funds)[559]. In contrast, certain pricing mechanisms should not be considered fees, even though they do not consist of interest rates, e.g., services priced in a way that mimics an interest rate. In addition, specific practical arrangements may be needed for certain types of services, such as high-frequency trading and derivatives contracts, for which the tax base and actual application of VAT could be subject to different approaches, such as so-called 'globalisation', i.e., the calculation of the taxable base as the difference between purchase and sale prices of all contracts over a certain period.

- **Insurance services**. The economic value added by an insurer is not the full premium it receives. Insurance is, at its core, a risk-pooling mechanism: policyholders pay premiums into a common pool, from which those suffering losses are compensated. The gross premium therefore has two conceptually distinct components: (i) the risk component: the expected actuarial value of future claims (a redistribution of resources among policyholders, not a value-added service); and (ii) the insurer's gross margin, which covers administrative costs, acquisition costs, claims management, overhead, and profit – this is the value added by the insurer. Accordingly, in economic terms, the VAT base for an insurance policy can be expressed as: VAT base = Premiums received – Claims paid. This net amount corresponds to the insurer's gross operating surplus, and is the appropriate measure of value added, analogous to the taxable margin in other sectors. When the claims are paid in kind (e.g. repair services for risk insurance policies), this presents no issues: the suppliers of the services will charge VAT to the insurance company, which will then be able to deduct it. When the claims are paid in forms of monetary sums to the policyholders, there is no VAT associated, and this would require granting a fictional deduction right to the insurer on such sums. An example is provided in Box 18 on the treatment of those flows in New Zealand, which provides for VAT deduction on B2B claim flows, but not on B2C claim flows – *de facto*, in this case, VAT works as an IPT.

Box 18. Taxation of added value of insurance services in New Zealand

In New Zealand. Under the Goods and Services Tax Act 1985, non-life (general) insurance is fully subject to GST at 15%, while life insurance and pension products remain exempt. The mechanism operates as follows.

Premium flows. The insurer charges GST on the premium payable by the policyholder, which constitutes a standard taxable supply:

- Business policyholders (GST-registered pay the premium inclusive of GST and reclaims it as input tax credit. The net cost is the premium excluding GST.
- Private consumers: pays the premium inclusive of GST and cannot reclaim it. The GST is the intended tax burden on final consumption.

Claims flows. When the insurer pays a claim, the GST Act applies a "deemed supply" mechanism to ensure the full transaction remains within the GST system:

- Business policyholder: the insurance settlement is treated as the consideration for a deemed supply of the damaged or destroyed goods (or rights) from the policyholder to the insurer. The GST-registered policyholder accounts for output GST on the claim received; the insurer claims that amount as an input tax credit. The insurer's net GST liability thus reflects only its value-added margin. Private consumer: the claim payment is not subject to GST. The tax is borne on the full premium. The GST works like an IPT

- **Life insurance**: In principle, insurance premiums should be treated as fees. However, life insurance policies commonly include an investment component. Taxing the premium in full would hence

[559] The definitions and examples of financial service fees included in International Accounting Standard (IAS) 18 are helpful in this regard. IAS 18 distinguishes between fees earned for services provided (e.g. for servicing a loan, commitment fees to originate a loan, investment management fees) and fees that are an integral part of the effective interest rate.

result in taxing the underlying investments. To address this problem, two solutions are possible. The most radical solution would be to maintain the exemption for life insurance policies, similarly to what done in most Member States, which exclude them from the application of IPTs. However, this could lead to distortion with respect to other type of investment products, whose fees would be taxed. Another solution would be to apply VAT only to the share of the premium which covers for the life risk, excluding the nominal value of the underlying investment from the taxable basis.

- **Grey areas and risks of price arbitrage**: by differing VAT treatment for interest-based vs fee-based services, consideration 3B would also need to reduce the scope of grey areas where the tax treatment is unclear, and the related risk of operators trying to circumvent the definitions for tax purposes[560]. Importantly, this aspect has not been observed as problematic in jurisdictions taxing these services, such as Japan, Australia and New Zealand, where market practices, in terms of payment structure, remaining unchanged. Nonetheless, three mitigation measures are considered:
  - **Exhaustive list**: this would entail an exhaustive list of services and the considerations charged for them which should be considered as fees and thus taxed. Similar to the Japanese approach, the list could include (i) considerations paid by merchants and acquirers for credit and debit cards, (ii) considerations for bank transfers, cheques, and other payment services, (iii) considerations for current accounts and other deposits; (iv) considerations for the issuance and trading in securities, possibly not charged on a transaction-by-transaction basis.
  - **Presumptive list**: under this approach, there would be a general provision establishing that financial or insurance services paid via fees, commissions, or an equivalent consideration should be taxed. This would be complemented by a non-exhaustive list of services whose consideration should be considered as fees, as well as by a non-exhaustive list of services whose consideration should not be considered as such.
  - **Specific provisions for the granting of credit**: This measure specifically tackles the product area for which the risk of arbitrage is most evident, i.e. services which are priced by a combination of fees and interest rates, and in particular the granting of credit. To avoid this risk of arbitrage, an exception could be introduced such that the granting of credit and the associated services would remain exempt under the new regime, by considering this ex lege an interest-based service regardless of the price structure. Such an arrangement could also be extended to cover credit guarantees, given that they are typically provided as joint services and usually remunerated via fees.
- **Place of supply**: under the current rules, financial services follow the 'normal' place of supply rules prescribed by Articles 44 and 45 of the VAT Directive: when provided to a taxable person (B2B), they are taxed in the Member State of destination, i.e. the Member State of establishment of the recipient of the service; when provided to a non-taxable person (B2C), they are taxed in the Member State where the supplier is established. There would thus be an incentive to provide B2C services from a low VAT rate jurisdiction – i.e., a Member State that has a low standard rate or that has introduced a very low reduced rate should the latter be allowed. This would be possible within the Single Market, since, via the free provision of services, financial institutions could offer services to any consumer in the EU from anywhere in the EU. To reduce this risk, it is thus proposed that the removal of the exemption is accompanied by a revision of the place of supply rules, providing that the place of supply of financial and insurance services is always the Member State of destination, i.e. where the customer is established, resides, or has its fixed establishment to which the services are provided. To avoid the burden of VAT registration in customers' Member States, suppliers could avail themselves of the OSS mechanism currently in use inter alia for distance sales of goods. This would be in line with the general trend of the EU VAT system of expanding the destination principle in combination with the OSS.

[560] In economics, this is known as 'waterbed effect', whereas the regulation or taxation of part of the price for a service consisting of various components / prices leads to an increase in the price of the unregulated or untaxed part, cf. Schiff, A., The 'Waterbed' Effect and Price Regulation, October 31, 2007.

- **Taxation of derivatives.** Should the exemption be removed for all financial products, transactions in derivatives would also become taxable. This would be challenging, given that there exist different methods to calculate the notional value of a derivative contract, which, in turn, can be much larger than the 'economic' value of the transaction. In this respect, the approach proposed would leave most derivatives outside the scope of VAT (rather than being exempt). Obviously, any fee charged for the issuance, trading or closure of derivative contract would still become taxable, regardless of the approach taken to the taxation of the contract *per se*. More in detail, the approach distinguishes between options and 'lock' derivative contracts.
- Options provide the buyer the right to enter into a contract at a predetermined price and under predetermined conditions. By entering into an option, the counterparty 'commits' to do something (i.e. to enter into a contract), and therefore supplies a service to the buyer; the granting of an option is, as a consequence, to be considered as a taxable supply for consideration, i.e. it is in the scope of VAT.[561]
- 'Lock' derivative contracts, include e.g. forwards, futures, and swaps. These do not create a right for one party to the contract and a corresponding obligation for the other party; rather, both parties to the contract commit to a pre-determined behaviour (e.g. trade a certain security at a later stage at a certain price) without receiving any consideration up front. The profits (or losses) for the party will be determined by the trend in the value of the underlying security at the time the contract is executed or closed out. Accordingly, the issuance and trading of futures, forwards and swaps as well as their settlement in cash, would be considered out of the scope of VAT, because there is no supply at that stage; if the contract is closed out by executing the trade, the latter transaction would then be within the scope of VAT and thus taxed.[562]

11.4.2 Policy Consideration 3C – Introduction of an FAT for all financial services, with VAT zero-rating and removal of sectoral taxes

➢ Overview

The analysis considers the introduction of a Financial Activities Tax (FAT) together with the replacement of the VAT exemption with zero-rating and the removal of sectoral taxes[563].

A FAT is a tax on the added value of financial institutions, defined as the sum of companies' profits and remuneration (i.e., wages)[564]. By using this tax base, the FAT would aim to mimic the economic effects of VAT while avoiding its practical difficulties, such as determining the appropriate consideration on interest-based services. This would entail two related differences compared to VAT. Firstly, instead of a transaction basis, the FAT would be applied to added value created over a time period (e.g., per financial year). Second,

[561] In contrast it is argued in the literature that if options are acquired purely for speculative reasons, without a nexus to the economic activity (by analogy to the acquisition of equity instruments), then the activity should be considered out of scope. Cf. Englisch, J. (2018). Financial Investments: European Union in RF. van Brederode & R. Krever (Ed.), VAT and Financial Services: Comparative Law and Economic Perspectives (pp. 257-299), Springer.

[562] Cf., for instance, the German guidelines on the VAT treatment of various financial services: Umsatzsteuerliche Beurteilung der Leistungen im Wertpapier- und Depotgeschäft, BMF v. 03.02.2015 - IV D 3 - S 7160/14/10002.

[563] For modelling purposes all sectoral taxes would be removed, following the same logic described above for considerations 3A and 3B.

[564] Cf description and implementation modalities of the FAT inter alia in International Monetary Fund. (2010). A Fair and Substantial Contribution by the Financial Sector –Final Report for the G-20, Prepared by the Staff of the International Monetary Fund, cf.

https://www.imf.org/external/np/g20/pdf/062710b.pdf. The advantages and disadvantages of the FAT are also discussed in European Commission (2010), Financial sector taxation – Taxation papers, Working paper no 25-2010 Luxembourg: Office for Official Publications of the European Communities, DOI 10.2778/1549; and European Parliament (2025), *The taxation of the EU's financial sector. Options and experiences*, prepared by Atanas Pekanov and Margit Schratzenstaller from Austrian Institute for Economic Research, prepared for FISC Subcommittee. Hereinafter: EP Study (2025).

the FAT is not a cascading tax, meaning that there are no FAT-specific deductions either at preceding or subsequent stages of the value chain.

The main advantage of a FAT is the relative simplicity of its application. As highlighted by the IMF[565], the tax base concerns elements that companies already record and report on for purposes of corporate income tax and withholding taxes and social charges on remuneration. The FAT's main disadvantage is that, since it is not a cascading tax, it is not neutral for B2B transactions; rather, the costs of the tax would be invisible at the transaction level, and reflected in prices to all customers[566]. From a legal perspective, it would also need to be considered whether a legislative proposal concerning both the revision of the VAT exemption, and the introduction of a FAT could be considered as falling entirely within the indirect tax area, and thus finding a legal base in Article 113 of the TFEU, or whether it would be considered to also involve elements of direct taxation, thus possibly requiring a legal basis within Article 115 TFEU.

Box 19 below gives an example of the FAT in place in Norway, showing that such taxes have been applied in practice without major problems. In Italy, a tax with a similar tax base – IRAP, *Imposta Regionale sulle Attività Produttive* – is applied to all industries, including financial services, without significant complexities.

Box 19. The Financial Activities Tax in Norway[567]

Norway introduced an FAT (*Finansskatt*)in 2017 for the purpose of offsetting the effect of the VAT exemption in effect for financial services. Rather than a straightforward tax on the sum of profit and wages, the tax entails (i) higher tax on profits than ordinary corporate income tax (25% vs the 22% applicable to other firms) and (ii) a tax of 5% on gross wages. All employers engaging in the activities covered in NACE sectors K64, K65 and K66 are liable for the tax, with some minor exceptions for companies falling below certain thresholds for engagement in financial activities.

➢ *Practical considerations*

The analysis focuses on the **introduction of an FAT along with VAT zero rating of all financial services**, accompanied by the removal of the sectoral taxes identified for the study; as explained in the introduction above, the FAT would be enacted through a legislative initiative, while VAT zero-rating and the removal of IPTs would be removed by an amendments to the VAT Directive, and the removal of sectoral taxes would be accomplished through a Commission Recommendation. Importantly – following the approach used in Norway – the FAT would be applied at entity level. This means that, for all qualifying institutions, the FAT would be applied to all turnover, while all output would be zero-rated from a VAT perspective. This would accentuate the advantages of an FAT approach to taxing the financial sector, which would aim to simplify and increase the coherence of the tax framework.

The **tax base would be the sum of profits and remuneration** as outlined above[568], and the analysis is based on **neutral tax rates** identified with the study team's model, with a view to ensuring that the revenue from the FAT compensates for the loss of hidden VAT (due to the zero-rating of all or certain financial services) and of sectoral tax revenue.

An additional variant of this policy consideration was also identified. This would also aim for tax revenue neutrality, by applying the FAT and VAT zero-rating only to the profits and remuneration associated with interest-based services, while removing sectoral taxes and the VAT exemption for fee-based services. However, testing the combined effects of these tax measures showed that achieving revenue neutrality could only be achieved in some Member States through the introduction of extremely high VAT and / or

[565] *Ibidem* International Monetary Fund (2010).

[566] That said, the possibility of providing periodic statements on the amount of tax paid for the purpose of deduction by business customers is considered.

[567] For more information see the description of the Norwegian tax authority (Financial activity tax - The Norwegian Tax Administration).

[568] While the IMF, European Commission and European Parliament work on FATs notes that the tax base could be tweaked to target excessive profits and / or risk-taking, this would be inconsistent with the objectives outlined for the study and thus is not considered here.

FAT rates. For this reason – as explained in the box – this variant was deemed unviable and not retained for the full analysis.

Box 20. Partial application of the FAT: achieving revenue neutrality with an FAT and VAT zero-rating on interest-based services, VAT on fee-based services and the removal of sectoral taxes

An initially envisaged variant of policy consideration 3C would have limited the FAT only to interest-based services, for which it is difficult to apply VAT. This would be accompanied by VAT zero-rating of these services, the introduction of VAT for fee-based services and the removal of key sectoral taxes, namely IPTs, bank levies and salary taxes. From a fiscal perspective, this consideration was to be revenue neutral, providing an opportunity to simplify the tax framework while minimising the revenue impacts.

While conceptually promising, the policy consideration was tested and deemed unfeasible, and this not retained for the full analysis. The reasons for this relate to the characteristics of sectoral taxes and composition of the financial sector in a number of Member States, which would have required unrealistically high tax rates in order to achieve, or come close to, revenue neutrality.

To give more detail, currently, governments collect significant revenue from sectoral taxes on financial services. In 2023, IPTs and other similar levies on both fee and interest-based services generated around EUR 80 billion across the EU. At the same time, if all fee-based financial services were taxed at the standard VAT rate, which likely cannot be done with interest-based services, the additional revenue would be approximately EUR 30 billion.

This would create a gap. If sectoral taxes were removed and VAT at standard rate was imposed on fee-based services, governments would lose roughly EUR 50 billion in revenue. To keep total tax income unchanged (i.e. remain *revenue neutral*) at the EU level, other compensating measures would be required. One approach considered was to increase taxation on interest-based services, which make up about 40% of the financial sector's output.

At the Member State level, maintaining revenue neutrality would not always be particularly challenging. It could be achieved by introducing a FAT or a similar measure on interest-based services. In some cases, even such additional measures might not be necessary, especially where the following conditions apply:

- low existing sectoral taxes,
- a predominance of fee-based services,
- a high share of cross-border services, or
- a large proportion of services provided to private consumers.

However, **in a number of countries, the practical challenges of maintaining revenue neutrality would be difficult or not possible to overcome**. This is particularly the case in countries with the characteristics opposite to those mentioned – above all high sectoral taxes (since these would be removed for this policy consideration) and a predominance of interest-based services (where applying VAT could only partly compensate for the shortfall).

In these cases, maintaining revenue neutrality would require imposing very high taxes on interest-based services, in some cases above 100%. In practice, such rates would likely be economically and politically unfeasible. For this reason, the policy consideration of applying an FAT only to interest-based services, coupled with VAT zero-rating of these services, and VAT on fee-based services.

➢ *Further coordination of sectoral taxes*

While not a fully-fledged policy consideration, within consideration 3C the study also considers separate harmonisation measures on sectoral taxes. As discussed above, for reasons of legal and political feasibility, harmonisation by legislative means is deemed unviable and not retained for the analysis. Rather, further coordination is considered from two perspectives.

a legislative proposal on the harmonisation of sectoral taxes is deemed unviable and not retained for the analysis.

The first concerns the **Capital Duty Directive (CDD)**[569], which generally prohibits Member States from levying indirect taxes on the raising of capital, such as capital duty on company formation or capital

[569] Council Directive 2008/7/EC of 12 February 2008 concerning indirect taxes on the raising of capital; ELI: http://data.europa.eu/eli/dir/2008/7/2013-07-01.

increases. A standstill clause allows Member States that applied capital duty on 1 January 2006 to continue doing so, subject to strict conditions: the rate must not exceed 1%, the tax must be charged only once per transaction, and discontinued taxes may not be reintroduced. Such transitional measures are in place in Greece, Poland, Portugal and Spain, but other Member States apply indirect duties/taxes that potentially fall under the scope of the Directive, such as stamp duty on securities[570].

More broadly, the Directive restricts indirect taxation of corporate operations that create or reinforce a company's capital, thereby supporting the free movement of capital and facilitating equity financing over debt. Distributions of a company's assets (dividends, distributions in kind or share buybacks) fall outside the scope of the prohibition. The study assesses the likely impacts, most importantly in relation to reduced fragmentation, of an amendment to the CDD that would eliminate the transitional measures, meaning that the CDD rules would be fully harmonised. This measure could be implemented on its own, or alongside any of the policy considerations assessed.

Secondly, the study assesses **coordination by non-binding means, through a Commission Recommendation**, that would provide guidelines on the appropriate circumstances and approaches to applying sectoral taxes. This would be especially important for windfall taxes, which, as discussed in Chapter 6, are applied in widely varying ways, as well as FTTs, and stamp duties. Such a recommendation would be superseded by the Recommendation foreseen to remove sectoral taxes alongside considerations 3A(i)a and 3B(i)a, but could otherwise be implemented either on its own or as a complement to any of the policy considerations assessed.

11.5 Intervention logic

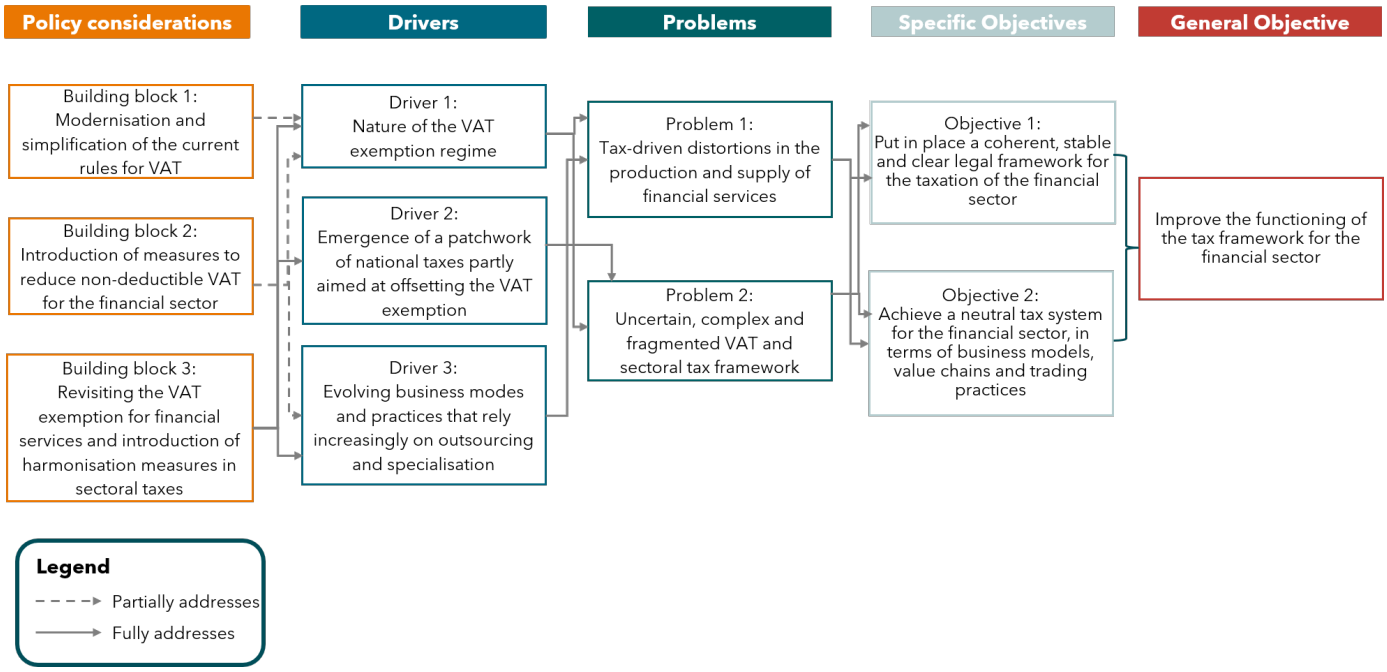
The intervention logic depicted in Figure 79 illustrates how the various policy considerations link to the underlying drivers and problems, and how these connections inform the specific and general objectives pursued. The relationships between elements are represented by arrows: solid lines indicate full relevance or influence, and dashed lines indicate partial relevance, as clarified in the legend.

Of the three building blocks, revisiting the VAT exemption is the only one that would fully respond to all three of the drivers identified, providing the greatest possibility of addressing the problems and contributing to the achievement of the objectives.

The other two building blocks – namely modernising and simplifying the current VAT rules; and introducing measures to reduce non-deductible VAT for the financial sector – would also aim to address the issues identified. However, because some of the problems relate to the nature of the VAT exemption, and the considerations under these building blocks would leave the exemption intact, the drivers, problems and objectives would only be partly addressed. The tax-driven distortions and the complex, fragmented VAT and sectoral framework would thus persist, at least to a certain extent.

[570] For instance, Belgium imposes a flat-rate tax due on the purchase and sale of stocks and bonds, as well as on redemptions of capitalisation shares of collective investment vehicles executed by Belgian residents; Cyprus imposes stamp duty on commercial contracts, including the purchase of an existing business, if it concerns property situated in Cyprus. Stamp duty also applies to agreements relating to company reorganizations and certain transfers of bonds; Portugal applies stamp duty on loans or credit arrangements, with a rate structure depending on the repayment term. It also applies to other transactions such as the issuance of guarantees, sureties, pledges, and mortgages.

Figure 79. Intervention logic



Source: Authors' elaboration

PART C – Assessment of possible policy changes

The purpose of this final part of the report is to assess the impacts of the policy considerations. This is done in Chapters 12, 13 and 14 for Building Blocks 1, 2 and 3 respectively, in all cases by comparing policy change scenarios with a dynamic baseline scenario in which the current tax framework remained in place. Chapter 15 then draws overarching conclusions for the study on possible reforms to the tax framework for the financial sector. Since a coherent policy choice could entail a package of policy considerations from across the building blocks, it also identifies such packages and contrasts their likely impacts.

The **policy considerations entail potential changes to the current tax framework and its implementation**. The main impacts assessed are economic in nature, these include the impacts on sales of (i.e., demand for) financial services and tax revenues, legal certainty, regulatory costs, and impacts on market functioning (including aspects like trade in the Single Market and the international competitiveness of EU providers of financial services). Specific impacts on SMEs are highlighted wherever relevant. In addition, the structural reforms in Block 3 could be expected to reverberate more widely across the financial system, making it important to assess macroeconomic impacts as well as potential positive and negative social and environmental impacts. Since the relevant types of impacts vary to a certain extent by building block, the introductory sections on each building block explain in more detail which impacts are assessed.

For the **core economic impacts on sales and tax revenues, the main method is a partial-equilibrium model developed for the study**. This is used to model the tax burden in a detailed manner at different stages of the value chain, accounting for key economic effects (such as the income and substitution impacts resulting from changes in consumer and producer prices) and the interdependence between different tax instruments. **For the structural reforms in Block 3, the assessment is supplemented with a macroeconomic model.** This generates estimates for the impacts on sales and tax revenues from an economy-wide perspective, including 'second-order' effects. The macroeconomic model is also the primary means of assessing the macro-economic impacts of the policy considerations in Block 3, as well as providing input for the assessment of social impacts and international competitiveness.

The **other impacts are assessed using a range of quantitative and qualitative methods as appropriate**. In many cases (e.g., the application of the standard cost model – SCM – to the assessment of administrative costs), these mirror the methods used in Chapter 7 to assess the economic impacts of the current situation. In other cases, such as the assessment of social impacts on financial inclusion, additional methods have been devised based on the available evidence (model outputs, stakeholder feedback, existing secondary data etc.), with the priority on quantifying the impacts to the greatest possible extent. Since estimates about future outcomes necessarily entail high degrees of uncertainty, the reasoning and assumptions underpinning the analysis are explained throughout, along with levels of confidence and any limitations.

Before moving onto the assessment, the ensuing sections provide a brief introduction to the economic models to estimate the impacts. This starts with an overview of the analysis of tax incidence in the financial sector (concept introduced just below), which was used to estimate key inputs for the models, then considers the partial-equilibrium model and macroeconomic models in turn. More detail on each aspect can be found in Annex 2.1, 2.2 and 2.3, respectively.

➢ *Assessment of tax incidence in the financial sector*

The **'incidence' of taxation refers to who actually bears the burden of a tax**. This concept is distinct from who physically remits tax revenue to the tax authority and depends primarily on the interplay between elasticities of demand and supply, profit margins and market structures. For the study, tax incidence and resulting 'pass-through'[571] (a model formulation of tax incidence defined as the extent to which any cost changes are passed onwards to customers, as opposed to being absorbed by producers) are key parameters needed to estimate the impact of the taxes currently in place and the likely impacts of potential future changes. This section summarises the analysis of tax incidence conducted for the study.

[571] The pass-through rate can be defined as the extent to which variation in the tax burdens and other costs are absorbed by service providers or reflected in the price charged to customers; pass-through can vary between 0 (no pass-on, i.e., all taxes and costs are absorbed by the service provider) and 1 (full pass-on, i.e., all taxes and costs are charged to customers).

According to economic theory, **the extent to which companies pass the tax burden on to consumers depends on their profit margins and the price elasticities of demand**[572]. In perfectly competitive markets, market forces compel companies, in the long run, to pass the entire burden on to consumers. In markets with higher margins, companies have some pricing power, and may end up absorbing some of the tax burden in their margins. Demand elasticity also plays a role. When demand is highly elastic, producers (financial institutions in this case) are less likely to pass a large share of the tax burden on to customers, since the resultant price increases would lead to a substantial loss of business and profits. In other words, the 'pass-through' of the tax to customers is very limited. Conversely, in price-insensitive (i.e. inelastic) markets, providers are more likely to use their pricing power to shift the tax burden onto consumers, resulting in a relatively high pass-through.

Time dynamics also play a role. Pass-through for direct taxes may be limited in the short term due to contractual lock-ins or other factors preventing sudden price increases on specific services, but may increase over time as contracts are renegotiated and pricing structures adjusted. The nature of a tax, in terms of whether it applies to e.g., profits, balance sheets, or transactions, also may affect its incidence. Taxes that are easier to associate with specific services, such as transaction taxes like VAT, may be more readily passed on to clients.

Reliable measures of pass-through and elasticity are crucial for the economic models used for the study. However, a **screening exercise early in the process showed the existing empirical literature to be relatively scarce and ambiguous**, due to challenges such as the heterogeneity of services (both within and across countries), difficulty of price measurement and the limited number of tax events (i.e., changes in tax treatment through the introduction of a new tax or adjustment in rates) providing a basis for comparison.

To bolster the robustness and credibility of the economic models, it was thus **decided to build into the study itself a dedicated empirical analysis of tax incidence**. In very broad terms, this was done by collecting data on a wide range of price proxies and taxes applied to the financial sector over time. By identifying tax events and their correlation with changes in prices, it was then possible to isolate the tax burden from other factors as a determinant of price. While conceptually straightforward, this was a complex exercise that involved the systematic mapping of tax and price parameters across sectors and Member States, identification of a genuine tax events, and sophisticated statistical analysis to ensure robustness. Data from ECB and EBA (for banking) and ESMA (for other financial services) were invaluable to the process, as was HICP data from Eurostat for insurance.

For the purpose of the economic modelling, the **key results of the analysis** can be summarised as follows:

- Pass-through of taxes on products[573], such as VAT, is likely to be incomplete in the case of a broad and significant reform of non-tradable services as highlighted by own econometric analysis (Volume 2 – Annex 2); in particular, an increase of more than three percentage points in the effective tax rate would be expected to pass-through to prices in 70-80% of situations. Because the analysis concerns the long-term impact, when pass-through is expected to be higher, the baseline estimates in the economic modelling adopt the consensus assumption of an 80 percent pass-through rate.
- At the same time, in the longer term, demand is assumed to be inelastic, with the price elasticity of demand suggested by the abovementioned own analysis and the literature of around –0.5.

[572] Elasticity of demand (referred to as elasticity) is the extent to which variation in price for a product is reflected in variation of demand. It is defined as the ratio of the change in demand experienced from a given percentage change in price. Since demand ordinarily falls when prices rice, elasticity values are negative except in special cases. Values between 0 and -1 identify inelastic markets, in which the demand varies less than proportionately compared to changes in prices; values under -1 identify elastic markets, in which the demand varies more than proportionately compared to changes in prices.

[573] The focus here is on the pass-through ratios for taxes on products, which are the most relevant for the tax changes being assessed (particularly VAT. Pass-through was also derived for taxes on income and is presented in Volume 2 – Annex 2).

Given the uncertainty surrounding the assumed tax incidence parameter values and the context dependence of such numerical assumptions, additional sets of parameters need to be tested. Therefore, alongside the baseline results, the sensitivity analysis includes lower pass-through variants, for both high and low (absolute value) elasticity assumptions, as shown in Table 48.

Table 48. Pass-through and elasticity ratios used for the economic analysis

	Pass-through	Elasticity
Core scenario	0.8	-0.5
Ratios for sensitivity analysis		
Low pass-through and moderate elasticity	0.6	-0.5
Moderate pass-through and low elasticity	0.7	-0.2
Moderate pass-through and high elasticity	0.7	-1.0

Source: Authors' elaboration based on the econometric analysis presented in Volume 2- Annex 2

➢ *Partial-equilibrium model*

A specialised partial-equilibrium model was developed for the study to examine the likely impact of the policy considerations on (i) sales of financial services and (ii) government revenues from VAT and sectoral taxes. Before describing the model, it is important to consider the countervailing mechanisms that it would need to capture. In the case of VAT, these entail:

- **Imposition of VAT on certain financial services outputs**: several of the policy considerations entail changes to which financial services are exempt vs subject to output VAT. For policy considerations involving positive VAT rates on at least some financial services outputs, this would raise revenue for governments and increase prices for customers who do not have a right of deduction (particularly final consumers, but also governments and taxable persons carrying out exempt transactions, such as hospitals, schools, education institutions and small companies under the VAT threshold). This would increase tax revenues and put downward pressure on the demand for the services covered. Prices, including VAT, would also increase for business customers, but this would be offset by their right to deduct the VAT incurred as intermediate consumption.
- **Restoration of the right of deduction for certain financial services inputs**: the imposition of VAT to financial services as well as other measures under review (e.g., the super deduction variants of Consideration 1B) would restore (partly or fully) the right of deduction. This would reduce or eliminate the hidden VAT currently incurred on intermediate supplies, reducing costs for service providers as well as tax revenues, and putting downward pressure on prices, and thereby increasing demand.

From a VAT perspective, **the 'net' impacts on demand for financial services (i.e., sales) and VAT revenues will depend on the balance between the two countervailing mechanisms**. For example, in a scenario where the exemption is replaced with standard VAT for all financial services, without any changes to sectoral taxes, a net increase in tax revenues would be expected, alongside a drop in demand. This is because the VAT charged on the last (currently untaxed) step of the value chain would more than compensate for the lost revenues from eliminating hidden VAT.

In addition, **the fundamental reforms in Block 3 would in some cases be coupled with changes to sectoral taxes**, such as the removal of sectoral taxes or introduction of a new Financial Activities Tax (FAT). These taxes are not fractionated taxes like VAT and hence the mechanisms are simpler – their removal leads to reduced costs, prices and tax revenues, coupled with increased demand; introducing or increasing such taxes has the opposite effect.

The **partial-equilibrium model works by defining mathematically the inter-relationships between a tax base** components at all stages of the value added chain using highly specific parameters of the VAT system By simulating changes in one or more parameters (for example, the elimination of the VAT

exemption increases the share of deductible input VAT from the current low rates to 100%), the model is able to estimate the direct (or 'first-order') impacts on sales of financial services and tax revenues once equilibrium with the examined sectors is restored. **The 'impact' is defined as the difference between the values of these parameters in each 'change' scenario compared to the pre-existing baseline.** Estimates are made separately for every Member State, then aggregated to produce EU-wide figures, as well as sector and market segment (B2B vs B2C). The model also takes account of the interactions between VAT and sectoral taxes, thereby ensuring robustness with regard to the tax mix in addition to the effects of specific taxes. Importantly, the model assesses impacts on prices implicitly, as a function of changes to the costs faced by providers of financial services, and the pass-through ratio. As such, aggregate price impacts are built into the impacts on sales and tax revenues rather than reported on separately.

The **strength of such an approach is its simplicity**. Since the parameters, their values and the relationship between them can be readily depicted and justified, a partial-equilibrium model allows impacts not only to be identified but also explained in fairly straightforward terms. This is simplicity is also a drawback, in that a partial-equilibrium model neglects the effects of the policy change on other parts of the economy, and therefore cannot gauge impacts on a wider set of economic variables. The partial-equilibrium model is thus complemented with the macroeconomic model for two purposes, namely validation of results and to examine wider impacts.

Importantly, **the partial-equilibrium model has no time dimension**. While the analysis presents 'net' impacts, in fact straightforward tax increases like the imposition of output VAT will tend to be felt immediately through increased prices and tax revenues. In contrast, the dynamics of changes to production costs will materialise gradually depending on the situations of individual businesses and their value chains. The time dimension is captured by the macroeconomic model, which estimates impacts in terms of the maximum annual deviation to baseline (see below for more details on how impacts are calculated).

- ***Macroeconomic model***

For the fundamental reforms assessed in Block 3, the macroeconomic model is used to estimate how the impacts on sales and government revenues would evolve once second-order impacts are taken into account, as well as to estimate the impacts of the different policy considerations on the wider economic indicators, particularly employment, trade and GDP. The model used for this purpose is called NEMESIS, which stands for 'New Econometric Model of Evaluation by Sectoral Interdependency and Supply' and was already tailored and used for similar ends in the previous study.

In contrast with the partial-equilibrium model, **NEMESIS is a highly complex, pre-existing tool that uses over 200,000 equations across a wide variety of variables** to simulate, at a very detailed level (33 economic sectors and categories of products), the economies of every EU Member States and selected third countries (particularly Switzerland and the United Kingdom), as well as capturing their interactions with the Rest of World (RoW) countries. The model is regularly updated, meaning that it takes into account the economic effects of geopolitical crises such as the Covid-19 pandemic, Russia's invasion of Ukraine and energy and supply shocks, as well as EU policy developments such as the 2030 targets of the Fit for 55 package. It is calibrated using the same assumptions and sensitivity parameters. as the partial-equilibrium model, as well as additional sensitivity analysis regarding interest-rate changes.

For the policy considerations in Block 3, the model is used to produce estimates on a year-by-year basis up to 2030 for second-order impacts on sales and government revenues, and impacts on the wider economy, in terms of GDP components (GDP, final consumption, investment and the trade balance with third countries) and employment (distinguishing between high- and low-skilled jobs). In addition to scenarios where any changes in tax revenue are retained by governments or left in the economy (depending on whether increases or decreases are foreseen), the model also provides estimates for 'recycling' scenarios where these revenues are recycled either by adjustments to the VAT rates on other goods and services, or through lump-sum payments or taxes on households.

12. Building block 1: Modernisation and simplification of the current rules for VAT

The first building block comprises two policy considerations concerning specific adjustments to the existing provisions of the VAT Directive, which could be pursued to address the current fragmentation among Member States without fundamental reforms to the current exemption framework. The first of these (Policy consideration 1A) consists of changes to modernise the definitions of the VAT exemption, while the second (Policy consideration 1B) would aim to simplify and harmonise the rules on proportional deduction.

12.1 Policy consideration 1A: Modernisation of the definitions of the VAT exemption

To address the evolving landscape of financial services, five definitions under Art 135(1) of the VAT Directive and the definition of crypto-assets services have been identified as problematic and in need of intervention (see Chapter 8). The following subsections will analyse the possible impacts of a modernisation of the Directive through legislative action – unless otherwise stated, per type of definition considered. Where relevant improvements could be achieved through non-binding acts, this sub-option will be considered as well.

Overall, as summarised in Table 49 the interventions considered are expected to generate only limited VAT revenue impacts, as they affect, currently, relatively small portions of existing markets, without altering the overall structure of the exemption. The impacts will, as a consequence, mainly concern legal and regulatory costs and the Single Market.

Table 49. Impacts assessed for policy consideration 1A

Impact type	Overview	Means of assessment
Impacts on sales and VAT revenue	The expansion or reduction in the scope of the exemption due to the change in definition potentially affects VAT revenue and demand.	Qualitative due to both a limited scale of expected impacts the non-availability of sufficiently granular market and revenue data, except for the management of certain collective investment funds for which the economic analysis provided some quantitative estimations.
Impacts on legal certainty and regulatory costs	Updating and aligning the definition will have implications for legal certainty across operators, especially those involved in cross-border operations. Regulatory costs (including administrative burdens) are of very limited relevance in this intervention area.	Qualitative based on the findings of the legal analysis and the targeted consultation
Market impacts	Functioning of the Single Market and reducing the divergence of national frameworks.	Qualitative based on the findings of the legal analysis and the targeted consultation

12.1.1 Derivatives with a physical underlying

The analysis identified divergence between Member States in the VAT treatment of derivative transactions with a physical underlying (see Section 3.1.2 and Section 11.2.1). Under the current situation, there is no indication that Member States will naturally converge towards a common VAT treatment of derivatives with a physical underlying. This is mainly because the situation has persisted already for a long time. Legal uncertainty and divergent national practices are therefore expected to persist.

The proposed change would aim at **aligning the VAT treatment of derivatives with a physical underlying with that of derivatives with a financial underlying** – unless and until physical delivery actually takes place. Alignment could be achieved through either legislative or non-legislative measures. A formal amendment to the VAT Directive does not appear justified solely to address the limited divergences observed in the treatment of derivatives, which are not widely perceived as a major concern by stakeholders

or tax administrations. An alternative would be to amend Article 9 of the VAT Implementing Regulation[574], which already addresses the treatment of certain derivative instruments, although this would still require unanimous agreement in the Council.

Explanatory notes from the Commission may appear to be a more appropriate instrument for clarifying the VAT treatment of derivatives with a physical underlying. However, there is no assurance that Member States would align their national legal frameworks with such guidance. Moreover, reliance on explanatory notes could trigger a process in which stakeholders test the compatibility of existing national rules by referring cases to the CJEU. This would likely result in increased litigation costs and delay any meaningful gains in legal certainty for several years, until a judgment is delivered. Consequently, a non-legislative revision can be expected to be less effective, at least in the short term.

The proposed change **would significantly enhance legal certainty for the segment of the derivatives market in question**. Under this approach, the applicable VAT treatment would be clear at the time the contract is concluded and would not depend on ex post verification of delivery outcomes. The exemption would no longer hinge on whether delivery is foreseen in the contract or ultimately occurs. Any subsequent physical delivery would instead be treated as a separate taxable supply of goods. Such a solution would also **better reflect the functioning of derivatives markets**, where only a small proportion of contracts result in delivery and where the derivative instrument itself constitutes a distinct financial transaction. This approach is consistent with earlier Commission analyses on the treatment of options and similar instruments, which emphasised that derivatives do not, in themselves, transfer ownership of the underlying asset and should be regarded as financial instruments (other securities) falling within the scope of the VAT exemption for financial transactions.[575]

From a financial **market perspective**, derivatives with a physical underlying correspond to the asset class of commodity derivatives, whose value depends on the price of a commodity or a commodity index. According to the latest ESMA Report[576] available, commodity derivatives represent a negligible proportion of the total of derivatives trading (around 1%[577]), while there is no estimate on the share of which foresees physical delivery. Most derivatives contracts are not executed but are instead traded out, novated or settled in cash, with only a small minority resulting in physical delivery[578]. Accordingly, derivatives with a physical underlying represent a limited segment of the market, and any policy intervention would thus have only a modest impact.

From a Single Market perspective, the proposed change would eliminate existing discrepancies between Member States and ensure that market participants operate under equivalent VAT conditions. Currently, distortions may arise where operators established in Member States that tax such derivatives with physical underlying are able to deduct input VAT, while operators in Member States applying an exemption cannot. This may create competitive advantages in cross-border transactions, particularly when suppliers can avail themselves of the reverse charge mechanism[579]. A harmonised approach would also reduce the risk that

[574] Council Implementing Regulation (EU) No 282/2011 of 15 March 2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax.

[575] VAT Committee (2001), TAXUD/2409/01 – Working Paper No 304 VAT Committee – Question.

[576] European Securities and Markets Authority (ESMA) (2023), ESMA Market Report on EU Derivatives Markets 2023, available at: https://www.esma.europa.eu/sites/default/files/2023-12/ESMA50-524821-2930_EU_Derivatives_Markets_2023.pdf.

[577] i.e., EUR bn 3,300 out of a total of EUR bn 314,000 (notional amount). Cf ESMA(2023) ESMA Market Report on EU Derivatives Markets 2023 note 576.

[578] Cf VAT Committee (2001), TAXUD/2409/01 – Working Paper No 304 VAT Committee - Question "Typically, fewer than 10% of traded options are exercised. Instead, they are used as an investment or hedge vehicle, or as a means of transferring the risk of price movements in a manner which could be regarded as a form of insurance."

[579] Under the reverse charge mechanism, a financial operator established in a Member State where such derivatives are subject to VAT could sell them to operators in other Member States and deduct the input VAT linked to those taxable supplies. Conversely, operators established in Member States where the same transactions are exempt would not be able to claim such deductions.

Member States seek to attract commodity derivatives trading and clearing activities by unilaterally adjusting their VAT treatment.

The impact on VAT revenues of a possible revision (extension of the exemption) is expected to be limited. In the minority of Member States where derivatives with a physical underlying are currently taxed, VAT revenues would decrease, but this effect would be partly offset by a reduction in deductions for the associated input costs. Given that commodity derivatives account for only a small fraction of total derivatives trading, any revenue loss would be minimal. Likewise, limited impacts are expected in terms of administrative burdens or enforcement costs, as the current VAT treatment of derivatives does not appear to generate substantial administrative costs.

12.1.2 Management of certain collective investment funds, including pension funds

The main issues concerning the definition of collective investment funds stem from **Member State's divergent interpretations of what constitutes a special collective investment fund**. (see Section 3.1.2).

The CJEU has addressed the scope of the definition of the management of collective investment funds in several judgments[580], and the VAT Committee Guidelines[581] also clarified certain aspects of the exemption. Nevertheless, **these developments have not led to any substantial convergence of national legislation**[582]. The targeted consultation confirmed that the VAT exemption for the management of investment funds is still applied divergently across Member States and that the national case-by-case assessments often depend on qualitative criteria (e.g., the degree of investor protection) which are interpreted differently at national level. Hence, in practice, the scope of the exemption is shaped not only by legislation but also by national administrative practice and evolving domestic case law, leading to significant differences even between neighbouring jurisdictions.

Under the **no change scenario**, no substantial evolution of the current situation is expected. The continued existence of discrepancies in the VAT treatment of fund management means the likely persistence of distortions in the functioning of the Single Market, by subjecting economically comparable funds to different VAT systems depending on their place of establishment. This divergence results in materially different VAT outcomes for funds operating under the same EU regulatory framework. As presented in the economic analysis (see Section 7.1.4) this **divergence also influences business models and outsourcing decisions**[583]. As financial institutions and insurance companies generally have limited VAT deduction rights, VAT on asset management services becomes a cost. Consequently, broader exemptions may encourage greater outsourcing: specifically, insurance companies are more likely to outsource asset management in countries where such services are exempt, reflecting the legal uncertainty and divergent interpretations in this area. In contrast, banks do not appear to outsource more in countries with broader exemptions, possibly because asset management is more commonly integrated into their core service offerings and therefore performed in-house regardless of VAT treatment.

To address these distortions and improve legal certainty for the **management of collective investment funds**, the potential policy changes centre on:

- **clarifying the scope of the exemption in line with existing CJEU jurisprudence** – including UCITS, non-UCITS funds equivalent to UCITS and defined-contribution pension funds including Pan-European Personal Pensions (PEPP), or

[580] Cf. Judgment of the Court of 7 March 2013, *Wheels Common Investment Fund Trustees and Others*, Case C-424/11; cf also Judgment of the Court of 13 March 2014, *ATP Pension Service*, C-464/12. Cf. also Judgement of the Court of 8 October 2020, *United Biscuits (Pensions Trustees) and United Biscuits Pension Investments*, C-235/19.

[581] Cf. VAT Committee Working Paper No 936, taxud.c.1(2017)6168695, 9 November 2017, and the ensuing Guidelines resulting from the 109th meeting of 1 December 2017 taxud.c.1(2018)3869725– 949.

[582] Even more recently the Dutch court asked the CJEU for a preliminary ruling on the comparability of pensions funds to investment funds, which signals a lack of clarity on the scope of the exemption. Cf Judgment of the Court of 5 September 2024 *X and Others v Inspecteur van de Belastingdienst Utrecht and Others*, Joined Cases C-639/22 to C-644/22, ELI: http://data.europa.eu/eli/C/2024/6056/oj.

[583] Cf Section 7.1.4.

- as put forward in the 2007 proposal, **extend the exemption explicitly to all pension funds**.

The first change proposed would aim to **align the VAT treatment of the management of funds across the EU by explicitly anchoring the exemption to the UCITS-equivalence test** in line with existing CJEU jurisprudence.

Such an alignment would reduce but not, in itself, fully eliminate legal uncertainty, as the application of the exemption would continue to depend on the interpretation of UCITS-equivalence. **Explanatory guidance could supplement this** and thereby further reduce uncertainty, for example by identifying objective indicators such as the fund's primary target investors. Nonetheless, the adoption of a secondary legal act does could be feasible at this stage, only if strictly involving a common VAT definition of UCITS equivalent at the EU level. The areas concerned are widely regarded by national authorities as falling within the exclusive national competence, particularly in the fields of social and labour law, but business providers would appreciate more consistency across all Member States.

When it comes to **market and VAT revenue implications**, **the change would have different impacts for AIF and for pensions**. In Member States where the management of AIFs currently benefits from a broad or quasi-general exemption, this would result in a narrowing of the scope of the exemption eliminating unequal treatment of comparable funds within the Single Market. Due to data limitations, the exact share of AIF subject to case-by-case assessment cannot be precisely determined, as EU-level statistics typically aggregate AIF without distinguishing national classifications[584]. Cross-border AIF data can be used as an indicative proxy: this indicates that cross-border AIF represent around 18% of the net assets of EU-domiciled funds and is highly concentrated in a limited number of Member States. In particular, EFAMA[585] reports that Luxembourg and Ireland act as the main hubs for cross-border funds domiciled in Europe. Among these two, only Luxemburg currently exempt VAT on AIFs, which suggests that any changes to the exemption for the management of AIF would likely have a more significant impact in this market. Similarly, beyond the cross-border fund market, countries such as Germany and the Netherlands which currently exempt VAT on AIFs and have a high concentration of these services in terms of absolute number and net asset value[586], will likely be impacted in terms of sales and VAT revenues.

The **narrowing of the exemption would likely generate additional VAT revenues**, as many of the AIFs that would be taxed are targeted at professional investors who are generally unable to deduct VAT. This increase would be partly offset by improved VAT recovery for fund managers. At the same time, the persistence of non-deductible VAT could lead to additional costs along the AIF value chain and for professional investors. Due to the lack of comprehensive data on the structure of AIFs affected, these impacts cannot be quantified.

For **pension funds**, aligning the scope of the exemption with existing CJEU jurisprudence would harmonise approaches by exempting from VAT only the management of defined contribution schemes. Consequently, asset management services supplied to defined benefit pension funds would become taxable in those Member States currently exempting them. This would increase costs for such funds and, indirectly, for

[584] e.g. ESMA, Online Investment Firm Registry, available at: https://registers.esma.europa.eu/publication/searchRegister?core=esma_registers_upreg; EFAMA (2024), Asset Management Report 2024 available at : https://www.efama.org/sites/default/files/files/asset-management-report-2024.pdf (last accessed May 2026).

[585] EFAMA (2024), Asset Management Report 2024 available at : https://www.efama.org/sites/default/files/files/asset-management-report-2024.pdf (last accessed May 2026).

[586] Cf ESMA (2025), ESMA statistics on securities and market, p. 12 Table 8 Number of fund managers, funds and fund net asset value by regulatory framework available at: https://www.esma.europa.eu/sites/default/files/2025-12/ESMA11-239717167-20877_ESMA_statistics_on_securities_and_markets.pdf (last accessed May 2026).

beneficiaries and future pensioners particularly in Member States where defined benefit schemes remain widespread and currently benefit from exemptions, such as Germany and Spain[587].

If, per the second change considered, the exemption would be extended to all **pension funds, these would be treated as a distinct category of investment vehicles, defined by their purpose** rather than by the allocation of investment risk. The VAT exemption would be extended to the management of all pension funds, including defined benefit schemes. From a legal certainty perspective, a higher degree of harmonisation on pension funds would enhance clarity and consistency in the application of the VAT exemption across Member States. Such an approach has also been supported by representatives of the sector since the 2007 proposal. At the same time, extending the scope of the exemption would modify the current tax treatment in the majority of Member States where the management of defined benefit schemes are presently taxed, and may therefore require a period of adjustment for market participants and tax administrations.

The budgetary impact of this possible revision would be rather limited across Member States due to smaller pension fund markets[588] or a declining prevalence of defined benefit schemes. For instance, in the Netherlands, defined benefit schemes are currently subject to taxation. However, as the country is transitioning towards a defined contribution system[589], the overall impact would likely be limited. One Member State that was not covered by the legal mapping, but where the impact could be more significant, is Finland. This is due to its large defined benefits pension fund market, which is currently taxed.[590] At the same time, exempting the management of these pension funds would reduce the VAT burden currently borne by pension funds and, to the extent that the resulting cost savings are passed on, by beneficiaries as well.

12.1.3 Supporting payment services

The current VAT exemption of supporting payment services, as interpreted by the CJEU[591], applies only to **transactions that are specific and essential to a payment**, in the sense that they affect the legal and financial transfer of funds and alter the financial situation of the parties. As a result, most supporting payment services remain taxable, even where they go beyond a purely technical supply.

The current restrictive interpretation has led to an asymmetry within the financial services value chain and has become more pronounced as new market participants enter the payments ecosystem, both from a legal certainty and Single Market perspective. Technological developments in electronic and instant payments have fostered greater unbundling of payment functions and facilitated entry by non-traditional financial services businesses. The payment process became increasingly modular, with a growing share of payment-related activities being carried out by intermediaries whose services fall outside the scope of the

[587] European Central Bank (ECB) (2026) Pension Fund Statistics, available at: https://www.ecb.europa.eu/stats/pdf/money/pf/ecb.pfd_overview_tables.en.pdf?69e5af6f21d9d7c5f7ec06ac017459fe Cf also PensionsEurope (2025) PensionsEurope Report 2024 – Trends and developments in funded pensions. *"Spanish pension fund assets in derivatives accounted for €282m in the same period, German pension fund assets in derivatives for €41 m, while Irish pension fund assets in financial derivatives accounted for €38,57 m. In the euro area, at the end of Q4 2024, Dutch pension assets in financial derivatives account for 99,42% of the euro area pension funds' assets in financial derivatives (€93,93bn out of the total €94,48 bn)."*

[588] European Central Bank (ECB) (2026) Pension Fund Statistics, available at: https://www.ecb.europa.eu/stats/pdf/money/pf/ecb.pfd_overview_tables.en.pdf?69e5af6f21d9d7c5f7ec06ac017459fe

[589] Pensions Future Act, available at: https://wetten.overheid.nl/BWBR0048328/2026-01-01 (last accessed May 2026)

[590] Cf Finance Finland. (2025). Finnish pension system and VAT; cf also Finance Finland. (2025). VAT on finance sector: Pension insurance companies.

[591] Cf Judgment of the Court of 5 June 1997, *Sparekassernes Datacenter (SDC) v Skatteministeriet*, C 2/95, EU:C:1997:278., Cf *also* Bookit (on credit card data handling), AXA UK and DPAS (on the management of debit plans and direct debits), and Cardpoint (on ATM services). *Crf.* CJEU judgment of 26 May 2016, *Bookit, Ltd v Commissioners for Her Majesty's Revenue and Customs*, C 607/14, EU:C:2016:355; CJEU judgment of 28 October 2010, *Commissioners for Her Majesty's Revenue and Customs v. AXA UK plc*, C 175/09, EU:C:2010:646; CJEU judgment of 25 July 2018, *Commissioners for Her Majesty's Revenue and Customs v DPAS Limited*, C 5/17, EU:C:2018:592; CJEU judgment of 3 October 2019, *Finanzamt Trier v Cardpoint GmbH*, C 42/18, EU:C:2019:822.

exemption, reducing the proportion of the value chain that benefits from VAT exemption. While stakeholders have mentioned competitiveness issues deriving from the lack of clarity of the definitions, as mentioned in the economic analysis (see Section 7.1), differences arise from business models rather than the exemption itself. Traditional banks typically provide bundled payment and supporting services that are fully exempt, whereas specialised providers often supply only supporting services, which are taxable.

The CJEU has determined in multiple decisions the requirements to distinguish between payment services as such, which are exempt, and other supporting services[592]. Under the current interpretation the exemption hinges on whether a service effects a legal and financial transfer of funds. This has the effect of excluding a growing category of intermediary services which, while not executing the transfer itself, are nonetheless integral to its completion. Authentication, verification, and payment data handling services actively ensure the authenticity, integrity, and security of transactions and may even entail liability for transaction clearance, yet remain outside the exemption because they do not themselves trigger the legal transfer of funds.

A **modernised approach incorporating such services would not merely extend the VAT exemption in a formal sense, but would recalibrate its functional boundaries to better reflect the operational realities of contemporary payment systems.** However, any revision in this area must be carefully calibrated (ensuring that the impacts on hidden VAT are taken into consideration) to avoid shifting the system from one in which most services are taxed to one in which the entire value chain becomes exempt.

Non-binding explanatory notes would not impact the current situation as they would still leave room for interpretation and different application across Member States in an area where certainty is now required. For this reason, **a targeted intervention through an Implementing Regulation seems more appropriate** as it would clarify the scope of the exemption by introducing a white list of exempt services and a black list of taxable services, thereby expanding on the definitions contained in the VAT Directive while ensuring uniform application across Member States.

Such a revision would, first, increase legal certainty in an area characterised by frequent litigation and repeated referrals to the CJEU. Secondly, by clearly defining which supporting services fall within the exemption, it would provide a more predictable legal framework for innovation in payment services and business models, recognising the role of emerging providers in digital payment ecosystems and accommodating the likely evolution of the sector in the Single Market. This would be particularly significant in ensuring that the VAT framework does not inadvertently hinder the scaling of digital and cross-border payment solutions. Importantly, in order to ensure that the existence of the lists do not correspond to a too rigid legal framework, it would need to be reviewed and assessed regularly.

At the same time, extending the exemption to additional supporting payment services would reduce **VAT revenues for Member States**. Because these services are mainly B2B provided to financial institutions with limited deduction rights, VAT charged under the current regime is largely irrecoverable and thus generates revenue. Exempting these services would eliminate that revenue stream and shift the incidence of non-deductible VAT upstream, where it would be absorbed by service providers rather than passed on to the customer.

The magnitude of this impact cannot be quantified in the absence of reliable data on the value of these services. The typical costs per transaction of these services change depending on the service and the infrastructure used. As in other financial services value chains, the revenue effect would depend on the cost structure of payment service providers. In this sector, the share of costs attributable to IT infrastructure and external services is presumed to be relatively high, implying that changes in VAT treatment could have a non-negligible effect on irrecoverable VAT and pricing structures.

12.1.4 Insurance intermediation and insurance-related services

Article 135(1)(b) to (f) of the VAT Directive exempts, inter alia, transactions concerning insurance, credit, and payments, as well as "the negotiation" of such transactions. By explicitly referring to "negotiation," the

[592] Cf note 591.

provision has been understood to confine the exemption for intermediary services to those involving brokers or agents, thereby narrowing its application to a specific category of suppliers. National frameworks governing insurance intermediation and outsourcing are highly fragmented and often depend on detailed sectoral regulation and administrative practice, making it difficult to establish a coherent typology of exempt and taxable services across the Single Market[593]. services (Section 3.1.2 and 11.2.1).

In the **no change scenario** (status quo), financial intermediaries will continue to face considerable legal uncertainty as regards the VAT treatment of their services. As confirmed by the Court's case-law[594], the exemption applies only where the intermediary plays an active role in bringing about a contract and does not 'merely' supply preparatory, administrative or technical services.

Therefore, two possible modifications are considered:

- Reformulate Art 135(1)(b) to (f) so that 'intermediation' replaces 'negotiation', to explicitly include sub-intermediaries and eliminate differences between financial and insurance service markets.
- Delink the scope of the exemption from the nature of the supplier, so that intermediation for insurance services would be covered.

To ensure clarity and prevent distortions, it is proposed to accompany this change with an **Implementing Regulation containing a non-exhaustive 'white list' and 'black list'** of services. While this list could broadly reflect the current scope of the exemption in order to limit revenue effects, it is suggested that claims handling services be explicitly included in the white list. Claims handling already benefits from a VAT exemption in a significant number of Member States when supplied by brokers or agents, and it can reasonably be regarded as a distinct whole that is specific and essential to an insurance transaction, as it enables the insured party to receive indemnification when the insured risk materialises. Extending the exemption to claims handling in those Member States where such services are currently taxed would slightly broaden the scope of the exemption, but the overall market size is limited and the impact on VAT revenues is expected to be negligible.

As a result, certain forms of intermediation that are economically and functionally equivalent to traditional negotiation will still fall outside the exemption. This is particularly the case for digital and platform-based intermediaries, which typically operate through less standardised processes and automated customer journeys, as well as for multi-layered intermediation structures, where the intermediation function is distributed across several actors. In such cases, intermediaries may be excluded from the exemption even where their services are indispensable to the conclusion of the underlying financial or insurance transaction. This creates grey areas in the application of the exemption and may discourage innovation in distribution models due to the risk of losing VAT-exempt status.

Either of the change considered would primarily aim to **bring outsourced insurance services into line with the VAT treatment applied to the financial sector more broadly**, by allowing any outsourced insurance service that constitutes a distinct whole and which has the specific and essential character of an insurance transaction to benefit from the exemption, irrespective of the status of the supplier. This change would have limited effects on traditional intermediation activities, which remain largely reserved to licensed insurance brokers and agents under sectoral regulation and are already covered by the exemption. Instead, it would clarify the VAT treatment of other outsourced services within the insurance value chain and reduce legal uncertainty for non-registered service providers. As presented in the business and sectoral analysis (see Section 4.4) the market share of these services cannot be accurately quantified, as insurance services

[593] For instance, support services are generally taxable unless provided by an insurance intermediary as ancillary to insurance or intermediation services; however, the application of the exemption depends on the case at stake and the contractual arrangements. Insurance-related services, including claims handling, carried out by companies other than insurance brokers or agents are usually taxed but for instance, in Ireland, claims handling and other back-office support can be exempt when it forms an 'integral part of the insurance contract'.

[594] Cf Judgment of the Court of 11 December 2008, *Stichting Centraal Begeleidingsorgaan voor de Intercollegiale Toetsing*, C-407/07, EU:C:2008:713; CJEU judgment of 17 March 2016, *Aspiro*, C-40/15, EU:C:2016:172; CJEU judgment of 5 June 1997, *Sparekassernes Datacenter (SDC) v Skatteministeriet*, C-2/95, EU:C:1997:278; CJEU judgment of 3 April 2008, *Beheer*, C-124/07, EU:C:2008:196.

data are presented at channel-level i.e. looking at the number of brokers and agents. The absence of granularity on sub-services (e.g. digital platforms) and embedded distribution limits precision in assessing the scale of potential businesses affected. Nonetheless, ongoing digitalisation and the emergence of InsurTech and embedded insurance models are progressively expanding the range of insurance-related services performed by non-traditional and non-licensed providers[595]. These actors increasingly perform functions that are economically comparable to intermediation but may fall outside the scope of the exemption under the current legal framework. As a result, the relevance of the issue is expected to grow over time, potentially leading to distortions in competition and organisational choices within the insurance value chain.

While the overall economic impact of this problem is currently limited – as most intermediation services are still supplied by traditional agents and brokers who fall within the scope of the exemption – addressing it through a legislative amendment would enhance legal certainty and better align the VAT framework with current and future market structures. Given that only a limited number of operators would move from taxable to exempt treatment, the impact on VAT revenues is expected to be marginal, at least in the short term.

12.1.5 Custody services

The legal mapping of custody services revealed two main discrepancies in their VAT treatment across the EU. The first one concerns the treatment of bundled custody services: while in certain Member States[596] the principles established in Abbey National[597] have been implemented through administrative guidance specifying which services qualify for exemption and how to apportion taxable and exempt elements within bundled supplies, in others custody services are treated as ancillary to exempt transactions and therefore benefit from exemption. The second discrepancy concerns the treatment of electronic safekeeping, which is some Member States is considered within the scope of the exemption[598].

To address these issues, the proposed change aims to **explicitly align the VAT Directive with established CJEU jurisprudence**, and to clarify that **neither physical nor electronic safekeeping of securities is exempt**. Given that these clarifications reflect settled case-law, they could in principle be introduced through explanatory notes. However, a legislative amendment – either through a revision of the VAT Directive art 135(f) by adding the CJEU criteria or Implementing Regulation – would provide greater legal certainty and ensure uniform application across Member States. The absence of new action would leave the current situation unchanged, allowing discrepancies in the VAT treatment of custody services across Member States to persist, as confirmed by stakeholder consultations.

A key feature of the market for custodial services is that it is concentrated in a limited number of jurisdictions, due to factors such as economies of scale, financial clusters and regulatory ecosystems. While not the main factor, differences in VAT treatment have also contributed to this concentration with consequences on the Single Market. Where custody services are supplied cross-border to taxable persons, the reverse-charge mechanism generally neutralises VAT location effects. The situation differs, however, for custody services supplied to asset and fund managers, which constitute the main client base. If both the custodian and the asset or fund manager are established in Member States applying favourable VAT treatment to custody services, the latter may provide its services cross-border without incurring non-deductible VAT embedded in the custodian's fees. Though the influence could not be quantified, this

[595] Cf EIOPA (2026), Generative AI Market Survey: Outlook, Use Cases and Risk Management, available at: https://www.eiopa.europa.eu/publications/generative-ai-market-survey-outlook-use-cases-and-risk-management_en?prefLang=it#description (last accessed May 2026); cf also EIOPA (2024) EIOPA's Report on the digitalisation of the European insurance sector, available at: https://www.eiopa.europa.eu/publications/eiopas-report-digitalisation-european-insurance-sector_en?prefLang=it (last accessed May 2026).

[596] e.g. Germany and Italy.

[597] *Cf* CJEU judgment of 4 May 2006, *Abbey National*, C-169/04, EU:C:2006:289 stating that the exemption does not extend to: (i) the safe custody of the assets by a depositary; and (ii) fund administration.

[598] Cf section 3.1.2.

dynamic can incentivise the relocation of custody activities and results in VAT revenue losses for Member States from which such activities move.

The proposed changes would contribute to a more level playing field in the Single Market by ensuring that custody services are subject to the same VAT treatment irrespective of location. While this may reduce incentives for further concentration of custody activities in specific jurisdictions, it is unlikely to trigger a sudden relocation of existing global custodians, which remain embedded in local financial ecosystems. Over time, however, the revision could facilitate a more even development of custody services across the EU, or at least remove a barrier to such developments coming about.

Finally, from a VAT revenue perspective, the impact is likely to be mixed. In Member States where custody services are currently exempt, such as Luxembourg output VAT would increase. At the same time, custody banks and global custodians' deduction rates would improve. As many custody services are supplied cross-border the net effect on VAT revenues in current host jurisdictions could be negative.

12.1.6 Crypto-assets services

Several of the problems and solutions discussed in the foregoing sections involve reconciling outdated definitions with a financial sector increasingly characterised by outsourcing and a reliance on specialist niche providers, including fintechs. In addition to these, any comprehensive revision of the definitions covered by the exemption should also expressly encompass crypto-assets, including both transactions involving such assets and related services, such as digital wallets, exchange platforms, and other forms of crypto-asset intermediation.

So far, interpretative uncertainties have generally been resolved following the CJEU case law or the VAT committee guidance. With regard to crypto-asset transactions, most Member States that have aligned their approach with the principles established in Hedqvist[599], treating the exchange of crypto-assets for fiat currency, and vice versa, as VAT-exempt transactions analogous to those concerning currency. Similarly, exchanges between different crypto-assets are typically afforded the same treatment. The VAT Committee has also examined the VAT treatment of storage and transfer services (e.g. digital wallets), which are generally regarded as exempt where they qualify as transactions concerning payments or transfers.

Nevertheless, the existing legislative provisions, CJEU case law and VAT Committee guidelines do not provide sufficiently clear and comprehensive guidance on the VAT treatment of these services. In practice, this often necessitates a case-by-case assessment, increasing the risk of misclassification and generating uncertainty regarding VAT obligations for both businesses and consumers.

Given the rapid pace of technological innovation in the crypto-asset ecosystem, the potential impacts on innovation must be carefully considered. While the sector is no longer nascent, it continues to evolve quickly, with new business models emerging regularly. Importantly, clarifying the VAT treatment would not amount to regulating the underlying technology or financial model. Rather, it would provide legal certainty as to the fiscal treatment of transactions that are already taking place at scale.

Unlike more traditional crypto-asset exchange services, where convergence is already visible, it is not expected that a fully harmonised approach of the VAT treatment of emerging crypto-related services (e.g. decentralised finance – DeFi – services, complex wallet models, staking intermediation) will spontaneously emerge in the near future. Given that these services are inherently cross-border and digitally supplied, inconsistent VAT treatment is likely to hamper the functioning of the Single Market and may incentivise regulatory or fiscal arbitrage. This could lead to clustering of service providers in jurisdictions perceived as more favourable, for tax-driven reasons.

For this reason, the introduction of innovative services in a non-binding act would not be likely to improve legal certainty and reduce regulatory costs or improve the functioning of the Single Market. **Definitions and clarifications could be introduced in the Implementing Regulation or through a legislative amendment to the VAT Directive**. Given the fast-evolving nature of the sector, such measures could be

[599] Judgment of the Court of 22 October 2015. *Skatteverket v David Hedqvist*., Hedqvist, C-264/14EU:C:2015:718.

accompanied by an explicit review clause requiring the Commission to evaluate the functioning of the rules within a defined period (e.g. three to five years after entry into force).

The VAT treatment of crypto-assets developed largely through case law and administrative guidance, can be broadly systematised in a binding act. In particular:

- the exemption for the exchange of cryptocurrencies against fiat currency (and vice versa), as well as exchanges between cryptocurrencies that function purely as means of payment, is now relatively settled and could usefully be codified explicitly;
- the sale of NFTs – especially crypto art and other tokens with a practical use other than as a means of payment, should be clearly identified as generally taxable supplies, as they do not qualify as transactions concerning currency;
- custody and cold storage services, which are typically assimilated to traditional safe-keeping services, are generally subject to VAT; their treatment would follow any clarification or modification of the definition of custody services within the financial exemptions framework;
- for services that require a case-by-case assessment (e.g. certain exchange platform activities or mining services) clear legislative criteria could be introduced to reduce interpretative uncertainty.

Clarification at EU level of these crypto-assets services would not stifle innovation but could instead foster it within the Single Market by reducing legal uncertainty for operators and customers. Greater clarity may particularly benefit taxable persons engaging in crypto-asset transactions in a business context, who may otherwise face legal uncertainty as to their right to deduct input VAT or their VAT reporting obligations. As regards administrative burdens, clarifying the VAT treatment may increase compliance obligations for certain suppliers, especially where activities are confirmed to be taxable. Since administrative burdens are proportionately more costly for smaller and innovative companies, a sufficiently long phase-in period between adoption and entry into force could be envisaged to allow businesses to adapt their systems and processes.

Finally, **no significant impact on overall VAT revenues is expected in the short term**. Exchange transactions are already widely treated as exempt. While clarification could affect the VAT treatment of certain ancillary or innovative services, the overall size of these markets, although growing rapidly, remains limited compared to total EU VAT bases. The main effect of clarification would therefore concern legal certainty and the functioning of the Single Market rather than revenue generation.

While the VAT treatment of exchange transactions appears relatively settled, significant uncertainty remains in relation to ancillary and innovative services. In particular, DeFi arrangements raise structural challenges for the application of the exemptions. As mentioned in the legal assessment[600], the absence of a clearly identifiable legal entity makes classification and taxation difficult. One proposed approach would be to treat the entities that govern DeFi, i.e. the Decentralised Autonomous Organisations (DAOs) as deemed taxable persons. This would possibly require the appointment of fiscal representatives in the EU, although this would only be realistically enforceable where there is a connection to a legal entity and access to EU markets. Enforcement could also rely, where possible, on payment processors, though this becomes ineffective when crypto-payments bypass traditional intermediaries. As a first step, sectoral regulation, such as the MiCA Regulation[601], could impose a duty on crypto-service providers to VAT register or appoint a fiscal representative; however, compliance would likely remain complex. Overall, such reforms do not yet

[600] Cf section 2.2. Many DeFi services operate through smart contracts and autonomous protocols, without identifiable intermediaries performing a traditional "negotiation" function. This raises doubts as to whether such activities can fall within the exemptions for transactions concerning payments, transfers, or the negotiation of financial transactions under Article 135(1) of the VAT Directive. Moreover, as crypto-assets increasingly serve speculative or investment purposes rather than functioning primarily as a means of payment, the analogy with currency transactions may become less persuasive in certain contexts. These developments create a tangible risk of divergent approaches among Member States and contribute to growing legal uncertainty.

[601] Regulation (EU) 2023/1114 of the European Parliament and of the Council of 31 May 2023 on markets in crypto-assets, and amending Regulations (EU) No 1093/2010 and (EU) No 1095/2010 and Directives 2013/36/EU and (EU) 2019/1937 (Text with EEA relevance) PE/54/2022/REV/1

appear sufficiently mature for full implementation, except perhaps for the introduction of VAT-related obligations into MiCA. Their legal and technical feasibility would need careful assessment, and developments in DAO and DeFi ecosystems should be closely monitored to evaluate their growing significance for the EU economy and the practical challenges they pose to the VAT system [602].

12.1.7 Conclusion

The **modernisation of key VAT definitions applicable to financial services would primarily aim to improve the functioning of the existing framework rather than fundamentally alter its structure**. By clarifying the scope of exempt services and better aligning definitions with current market practices – particularly in light of digitalisation, innovation and increasingly complex value chains, such measures would enhance the consistency and interpretability of the rules across Member States. This is especially relevant in areas where legal uncertainty persists, including the treatment of outsourced services and new financial products, which have evolved significantly since the introduction of the exemption.

As such, the targeted changes discussed would be expected to improve legal clarity and coherence and thus form a beneficial part of any policy package that maintained the VAT exemption. While the overall impact on VAT revenues and economic outcomes is expected to remain limited, clearer and more up-to-date definitions would reduce ambiguity in the application of exemptions and contribute to a more uniform treatment across jurisdictions. This would, in turn, support a smoother functioning of the Single Market by mitigating discrepancies arising from divergent interpretations at national level. At the same time, these improvements would remain bounded by the structural features of the exemption framework, which continue to generate complexity and hidden VAT in the system.

[602] Cf Luchetta G., Bolognini A., Rohmer B. et al. (2026) Study on the challenges of VAT beyond VAT in the Digital Age, on file with the author.

12.2 Policy consideration 1B: Simplifying and harmonising the rules on proportional deduction

12.2.1 Introduction

Proportional deduction rules are crucial for financial service providers and tax authorities, as largely exempt outputs make them key to determining VAT liability. As outlined in the problem analysis (Section 9.3.2), most current complexities lie in the method for calculating partial deductions from mixed inputs. Therefore, simplifying or harmonising these rules would ease administration, reduce differences between Member States, and limit input distortions from exemptions. To do that, under this intervention area three variants will be considered:

- **Consideration 1B(i)**. **Simplification of the current rules**: this would designate the direct attribution method for taxed transactions and set the pro-rata method as the default method for mixed inputs.
- **Consideration 1B(ii)**. **Mandatory fixed rate of deduction**: instead of requiring individual calculations, this would require suppliers of exempt financial services to apply a fixed rate of deduction. To set the fixed rate two approaches are considered: one that reflect current average deduction levels, and a super-deduction rate.
- **Consideration 1B(iii) Optional fixed rate of deduction**: like the previous consideration, but suppliers of exempt financial services would be given the option of applying the fixed rate or traditional methods. Also under this variant, the fixed rates proposed reflect current average deduction levels and a super-deduction one.

Table 50 below provides a high-level overview of the nature of the impacts expected from this policy consideration, in terms of the effects across key dimensions and the corresponding methods used for their assessment. Overall, changes to VAT deduction rules may affect VAT revenues, improve legal certainty and reduce compliance costs, and have modest market impacts unless stronger measures (like super-deductions) are introduced to reduce hidden VAT and enhance market functioning.

Table 50. Overview of impacts

Impact type	Overview	Means of assessment
Impacts on sales and VAT revenues	Implications on the input VAT recovery mechanisms due to changes in the VAT deduction methods, which could lead VAT revenues to increase or decrease, depending on the method applied. Limited effects on sales are expected	Quantitative based on the economic analysis and partial-equilibrium model
Impacts on legal certainty and regulatory costs	Simplifying or harmonising the rules is expected to increase clarity and reduce litigation and compliance uncertainty across Member States. The proposed changes would likewise reduce administrative burdens borne by providers of financial services.	Quantitative based on the economic analysis as well as qualitative based on the targeted consultation
Market impacts	Changes focused on simplification or revenue neutrality would likely generate positive but limited effects on market functioning. More substantive effects would be expected under variants introducing super-deduction mechanisms. By increasing the extent to which input VAT can be recovered, these measures would directly reduce the level of hidden VAT embedded in financial services.	Qualitative based on the findings of the economic analysis, partial equilibrium model and the targeted consultation

The rest of this section is devoted to the analysis of each of type of impact in turn, followed by conclusions that compare these to the status quo. However, as a preliminary step, it is first important to set out the

deduction rates and other parameters used to estimate the economic impacts of considerations 1B(ii) and 1B(iii), and the reasoning used to arrive at these.

12.2.2 Fixed deduction rates, scope of the provision and changes to company behaviour

Since most financial services outputs are exempt from VAT, VAT liability in the sector depends strongly on the amount of input VAT that suppliers of financial services are able to deduct. Considerations 1B(ii) and 1B(iii) would introduce fixed rates of deduction, simplifying the rules and in certain cases increasing the deduction levels. To estimate the likely impacts, appropriate rates for the analysis need to be identified; in addition for consideration 1B(iii) on the optional fixed rate, the proportion of financial services providers that would opt into the regime and other key characteristics also need to be defined. These parameters then serve as inputs to the partial-equilibrium model used to estimate the impacts for these and other policy considerations; for a description of the model and how it works, see the introduction to Part C and Volume 2 - Annex 2.

The starting point is the current rate of deduction across the three sectors covered by the analysis. Table 51 presents the current VAT deduction rates across the EU, calculated as weighted averages based on national turnover data from the VAT analysis. Under the existing rules applied across Member States, banks are estimated to deduct nearly 30% of their input VAT, while insurance companies deduct less than 10%. Other financial service providers have an average deduction rate of approximately 20%.

Table 51. Current deduction rate – weighted average based on national turnover

	Banking	Insurance	Other financial services
EU27	29%	9%	22%

Source: Authors' elaboration based on VAT liability analysis

Consideration **1B(ii) would introduce a mandatory fixed deduction rate**, meaning that any provider of financial services would be 'assigned' a deduction rate. In this case, it is proposed that deduction rates are assigned at NACE-2 level, i.e. for banking, insurance and other financial services. Two approaches have been tested for the **geographical scope** of this policy change:

- Rates determined at **EU level**, i.e., a single rate is calculated and applied to operators in all Member States;
- Rates determined at **national level**, i.e., different rates are calculated and applied for operators established in each Member State.

In order to set the fixed deduction rate to be used, two different approaches are also considered, namely:

- rates aimed at mirroring current average deduction rates, at EU or national level, and
- a 'super deduction' rate aimed at increasing the ability of suppliers to reduce hidden VAT.

The **rationale for a super-deduction lies in its potential to reduce hidden VAT**. By 'artificially' increasing the deductible amount, a super-deduction directly lowers the tax cost of outsourced inputs. In doing so, it counteracts the tax-induced incentive to centralise services, thereby promoting a different allocation of resources and a more level playing field between vertically integrated firms and specialised providers. Some jurisdictions – notably Australia and Singapore – have experimented with enhanced input tax recovery schemes for financial services, through fixed recovery rates. While this improves neutrality, it also entails a reduction in VAT revenues, as part of the hidden VAT embedded in prices is effectively refunded.

The super deduction rate can be set at any level that provides greater compensation for deduction: the higher the rate, the lower the outsourcing distortion, and the higher the loss of VAT revenue. For testing purposes, this is set at 50% for all sectors, but other values could also be justified (including differentiated rates for the various sectors, e.g., a lower rate for insurance companies, given their current lower rate). The super-deduction option will be tested only using the 50% rate as determined at EU level. Introducing a new deduction system with nationally set rates would be inconsistent with the policy

objectives, notably the creation of a coherent legal framework aimed at improving the functioning of the Single Market.

Under **Consideration 1B(iii) an optional fixed deduction rate**, providers of financial services would be free to choose whether to opt for into the fixed rate or to use the pro rata. Optionality is particularly relevant for providers if the rate is fixed at current averages, because a significant share of operators will by definition have higher-than-average deduction rates in the current situation, and could continue using existing pro rata methods. In the case of a super deduction, the expected impact of optionality is more limited: the vast majority of operators would opt for the super deduction, excluding fringe providers which, for instance, focus on extra-EU exports or taxable financial services and already have very high pro rata.

Considering an optional fixed deduction rate based on current market average, it is proposed that **fixed rates are set lower than current average** levels to preserve VAT neutrality, e.g., at 80% of the current average rates. This accounts for the fact that, if optional rates were set at the current average level, the situation would create only benefits for providers of financial services, and only costs for government budgets.[603] For the optional super-deduction, the same considerations made for the mandatory super-deduction are valid.

Once the rate is fixed, the **likely behaviour of companies under the new regime needs to be simulated**. This means determining when a company is likely to opt for the fixed deduction rate, and the proportion of companies which are likely to opt. On the former aspect, it is assumed that companies with a deduction rate slightly higher than the fixed rate are also likely to opt for the new regime. This is because:

- The decision to opt is a decision made under **uncertainty**. The company will have to opt or not based on its past deduction rates and reasonable assumptions about how business variables are going to develop.
- Businesses show an aversion towards fiscal risk, which generates a "**safe harbour effect**". Companies may prefer a lower fixed reduction, rather than the administrative costs, complexity and litigation risks associated with the pro rata calculation. This means that companies may opt for a slightly lower deduction rate than they would obtain under the pro rata calculation, with a potential increase in VAT revenues.

There is no quantitative information on the size of these effects, so the study needs to rely on reasoned assumptions. It is assumed that companies with an expected deduction level at least 25% or 5 p.p. above than the fixed level (whichever is higher) would remain under the current proportional VAT rules. Deduction rates under consideration 1B(iii) and the threshold for remaining under proportional VAT deduction rules are shown in Table 52.

Table 52. Fixed deduction rates for consideration 1B(iii) and threshold for opting

	Banking	Insurance	Other financial services
Deduction rate (80% of current levels)	22%	8%	16%
Threshold for not opting (25% of 5 p.p. above than the deduction rate, whichever is higher)	28%	13%	21%

Source. Authors' elaboration based on the VAT liability analysis

Finally, to operationalise the assumptions, the share of companies whose deduction rate is above the threshold needs to be estimated. This is done based on detailed data from the targeted consultation. The

[603] Financial and insurance operators with a deduction rate below the fixed rate would opt for it, thus gaining from the policy change: financial and insurance operators with a deduction rate above the fixed rate would not opt for it, thus remaining in the same position as before the reform.

analysis considers the consultation data reported in the previous study[604], as well the data collected for this study. In 2021, the estimated uptake of the optional fixed rate for banking and investment service providers[605] was estimated at 68%; the new data confirm the validity of this value[606]. For insurance companies, the uptake was estimated higher, given that most players have very low deduction rates, at 80%.[607] The expected uptake is shown in Table 53.

To estimate impacts, the model accounts for the fact that companies which do not opt for the fixed rate have a higher *pro rata*. This is assumed to be, on average, 10 p.p. higher than the threshold for not opting. Since the data is patchy, it is only possible to make a reliable estimate at EU level, meaning that the analysis of the consideration 1B(iii) will not be carried out for national rates.

Table 53. Share of financial and insurance companies estimated to opt for the fixed rate

	Share of companies expected not to opt for fixed deduction rate	Share of companies expected to opt for fixed deduction rate
Banking and other financial services	32%	68%
Insurance	20%	80%

Source: Authors' elaboration based on targeted consultation

12.2.3 Impacts on sales and VAT revenues

The impacts on VAT revenues and sales with the introduction of a fixed rate of deduction are calculated based on the partial equilibrium model described in the introduction to Part C. For the fixed rate deductions, the model has been calibrated based on the current deduction rates and expected deduction rates described in the previous section. Results shown are presented in terms of the differences compared to the status quo scenario, in which current rules for the exemption and proportional VAT deductions are maintained.

Compared to the current framework, **consideration 1B(i) aims to standardise the calculation of input VAT deduction for suppliers of mixed-use inputs harmonising the methods used, thereby eliminating national divergences** (notably between actual-use, pro-rata and more liberal approaches). The measure is designed so as to be revenue-neutral compared to current deduction levels, and, as such, its impact on VAT revenues and sales is expected to be limited. Nevertheless, the harmonisation of deduction rules is likely to generate short-term adjustment effects and distributional impacts across Member States. Evidence from the economic analysis (Section 7.1.3) confirms that differences in national deduction approaches currently translate into measurable differences in deductibility: the share of input VAT deducted is lower in countries applying actual-use methods (around 1%) compared to countries applying pro rata, where deduction rates cluster around 6%. Accordingly, introducing a harmonised pro rata approach would primarily affect Member States currently applying actual-use methods, with an estimated average increase of around 5 pp in deduction rates. The partial equilibrium model suggests that this adjustment would result in a modest reduction in current VAT revenues of approximately EUR -1.5 million compared to the current VAT revenues in the EU.

[604] Rohmer B., Luchetta, G., Poli. F., Poniatowski. G. et al, (2021) 'Review of the VAT rules for financial services, in light of the existing regulatory and other indirect taxation rules', submitted to the European Commission in January 2021. Specific Contract TAXUD/2019/DE/313 (unpublished).

[605] Available data are sufficient to estimate this share for banking and insurance activities, but too few data points could be collected on asset management services. It is therefore assumed that the same rate calculated for banking applies, based on the relatively similar deduction rates experienced in these sectors.

[606] Based on 24 data points, i.e. banking and investment services providers that have shared their deduction rate, uptake is estimated at 67%.

[607] No sufficient data points could be retrieved from insurance companies during the new study, hence the previous estimate is used.

Compared to a mere simplification, the variants foreseeing the introduction – either optional or mandatory – of a fixed rate will have more substantial impacts on VAT revenues, significantly so in the case of the super deductions, as summarised in Table 54.

Table 54. Fixed deduction rates set at EU level – Impacts on VAT revenues (EUR bn)

Deduction rate	Sub-sector	Sector EUR bn	Total EUR bn
1B(ii). Fixed EU rate (current average deduction rate) **mandatory**	Banking	-0.3	2
	Insurance	-0.1	
	Other financial services	3	
1B(ii). Super-deduction **mandatory**	Banking	-12	-29
	Insurance	-14	
	Other financial services	-4	
1B(iii). Fixed EU rate (current average deduction rate) **optional**	Banking	3	7
	Insurance	-2	
	Other financial services	5	
1B (iii). Super-deduction **optional**	Banking	-12	-29
	Insurance	-14	
	Other financial services	-4	

Source: Authors' elaboration based on the partial equilibrium model

In absolute terms, the introduction of **mandatory fixed deduction rates at EU level (1B(ii), current average deduction rate) would have a limited and slightly positive impact on VAT revenues**, with an overall increase of around EUR 2 billion. However, negative absolute impacts on revenues can be expected in countries which currently apply the actual use. This is because the current regime in these countries is relatively strict, meaning that the policy change increases deductibility and thereby reduces VAT revenues. The fixed rate calculated at national level is not shown in the table, since, by definition, the deducted input VAT on aggregate remains the same and the impact is nil.

Moving to the **optional fixed rate (1B(iii), current average deduction rate), the proposed change generates a moderate increase in VAT revenues** (EUR 7 billion). This is due to the fact that a number of companies which would have a slightly higher deduction rate under the current method would opt for the certain and simpler fixed rate. From a sectoral perspective, impacts differ notably across NACE categories. Banking tends to drive most of the positive revenue effects under fixed-rate optional scenario, while insurance shows smaller and mostly negative impacts in some scenarios, suggesting that existing deduction practices are less variable and already closer to the proposed rates. Other financial services display the largest positive gains under fixed-rate options.

In contrast, **the super-deduction is expected by design to reduce VAT revenues significantly**. For these variants of considerations 1B(ii) and 1B(iii), revenue impacts are expected to be broadly the same whether the regime is mandatory or optional, as uptake would likely be near-universal given the strong incentive for firms to maximise deductibility. This was confirmed by the partial equilibrium model, which for both scenarios shows substantial revenue losses. These are estimated at around EUR - 29 billion, as higher deduction rates significantly reduce irrecoverable VAT, while output supplies remain exempt.

Impacts on sales (i.e., demand for financial services) follow impacts on VAT revenue, but move in the opposite direction (Table 55). Sales are expected to increase under the super-deductibility considerations – both fixed and optional, but the impacts remain quite limited, at about 1% of the current levels of demand. With the optional fixed rate, the impacts on sales are negative, but negligible, at between 0.1% and 0.3% of current levels.

Table 55. Fixed deduction rates set at EU level – Impact on sales

Deduction rate	Sub-sector	Sector EUR mn	Total EUR mn
1B(ii). Fixed EU rate (current average deduction rate) **mandatory**	Banking	90	-800
	Insurance	50	
	Other financial services	-900	
1B(ii). Super-deduction **mandatory**	Banking	4,300	10,100
	Insurance	4,500	
	Other financial services	1,400	
1B(iii). Fixed EU rate (current average deduction rate) **optional**	Banking	-1,200	-2,500
	Insurance	700	
	Other financial services	-1,900	
1B (iii). Super-deduction **optional**	Banking	4,400	10,300
	Insurance	4,500	
	Other financial services	1,500	

Source: Authors' elaboration based on the partial equilibrium model

Overall, while higher deduction rates – particularly under a super-deduction set at 50% can stimulate economic activity, **they do so at the cost of significant reductions in VAT revenues.** This is because irrecoverable input accounts for the vast majority of revenues in the financial sector. Conversely, more moderate or optional approaches can improve VAT neutrality and even increase revenues in certain sectors, while limiting adverse fiscal impacts.

12.2.4 Impacts on legal certainty and regulatory costs

As highlighted previously in the study (Section 9.3.2), while the current proportional deduction rules are problematic, this is mainly due to the complexity of application rather than legal uncertainty as such. Practical challenges are mentioned mainly in relation to cross-border contexts, where the application of different deduction regimes may give rise to legal uncertainty for financial services providers operating in multiple jurisdictions and on the actual-use method, which is generally perceived as more complex to apply.

Under the current situation, it is estimated that the **administrative costs stemming from the handling of proportional deduction rules are between EUR 135 and 450 million** per year for the entire sector. The previous study found that staff effort dedicated to this process can vary significantly from 0.1 to 4 FTEs, with the median falling at 0.7 FTEs. Once monetised[608], these administrative costs accounted for just marginal proportions of staff costs for typical companies. The targeted consultation showed that the situation around proportional VAT deduction has not changed notably for providers of financial services since then, allowing the results from the previous study to be updated and reused for these calculations. In the absence of further policy measures, meaning that no simplification or harmonisation of proportional deduction rules is being introduced, it is expected that the **administrative costs businesses currently face will thus remain stable over time**.

Considering the first variant B1(i), namely a **simplification of the currently existing rules** without altering the general approach to proportional deduction, financial institutions would still be required to calculate a pro-rata deduction percentage for mixed inputs. Consequently, the **core administrative burden associated with performing detailed pro-rata calculations would remain**.

However, harmonising and simplifying the existing rules would **reduce administrative costs linked to legal interpretation, documentation requirements and cross-border complexity**. In particular, the clarification of direct attribution rules and the establishment of a default pro-rata method for mixed inputs would provide greater legal certainty and reduce the scope for divergent national practices. For cross-border financial groups operating in multiple Member States, this could lower familiarisation costs, reduce the need for jurisdiction-specific VAT expertise, and limit the frequency of disputes or adjustments following tax audits. Moreover, it is foreseeable that the administrative burden for businesses in certain countries

[608] Eurostat Earning Survey, by Member States and type of professions; https://doi.org/10.2908/EARN_SES22_28.

could decline more notably, if the simplified and harmonised rules present a significant improvement in terms of complexity when compared to current rules. This could be the case, for example, in Germany, where the choice and execution of the calculation method often increase administrative burdens due to scrutiny by tax authorities.

While these savings are unlikely to eliminate the main cost driver identified in the baseline scenario – namely, the allocation of input costs and calculation of the pro-rata percentage – they could reduce the overall administrative burden, especially for institutions of a certain size and with activity in several Member States. In addition, greater harmonisation may contribute to **reducing fragmentation** in the application of VAT deduction rules across Member States, thereby **improving the level playing field within the Single Market**. Given that the underlying calculation mechanism remains in place, however, **overall administrative cost reductions are still expected to be moderate relative to the baseline**. These savings are not quantified as they would likely only materialise for a relatively small population of financial institutions and remain limited even for those, meaning that EU level administrative costs would likely remain within the same order of magnitude as the baseline costs and not materially alter the overall cost estimates.

Simplification may also reduce compliance risk and the need for conservative VAT provisioning, potentially lowering indirect governance and audit-related costs. These effects are not quantified separately, as they are expected to be limited in scope given that the main cost drivers would remain unchanged, and because the extent to which such simplifications would translate into measurable cost savings is inherently difficult to isolate and estimate.

Looking at the two variants introducing a **fixed rate of deduction**, the regulatory cost savings are expected to be more substantial. Under the **mandatory variant**, in which all operators must apply a fixed rate of deduction, the administrative costs associated with calculating individual pro-rata percentages would no longer arise. The various methods currently used to determine the share of deductible VAT would be replaced by the application of a predefined fixed percentage. In practice, businesses would identify the total amount of input VAT from their VAT ledgers and apply the assigned fixed deduction rate, without performing detailed allocation and pro-rata calculations. As a result, the **administrative cost savings are estimated to amount to roughly EUR 135 to 450 million per year**. In other words, the costs mentioned above for complying with the proportional deduction rules would be eliminated. The estimated savings would broadly apply to providers of financial services established across the EU. However, the impact may differ in Member States where simplified regimes already exist, e.g. the Italian Art.36-bis regime described in Box 21.

Box 21. Italian Art 36-bis regime

The so-called Article 36-bis regime relieves certain financial and insurance providers from the obligation to calculate detailed deductible VAT amounts. For operators currently applying this regime, the introduction of a mandatory fixed rate could alter existing administrative practices, potentially requiring more structured VAT record-keeping than at present. At the same time, such operators might experience changes in their effective level of VAT deduction, depending on how the fixed rate compares to their current treatment. According to the targeted consultation, a significant share of Italian insurance companies and a substantial proportion of banking operators (in terms of asset value) currently apply the Article 36-bis regime for their core activities. The overall impact in Italy would therefore depend on the detailed design of the fixed-rate mechanism and its interaction with the existing regime.

Under the **optional variant**, operators would be able to choose whether to apply a fixed rate of deduction or to continue using the existing proportional deduction method. Estimating the resulting reduction in administrative burdens therefore depends on the assumed uptake of the fixed-rate regime. Financial services providers that decide not to opt in would continue to incur the administrative costs associated with calculating individual pro-rata rates, whereas those opting for the fixed rate would benefit from the simplifications described under the mandatory variant.

Building on the reasoning applied in the previous section, it is assumed that approximately 71% of financial service providers would choose to apply the fixed rate,[609] the corresponding reduction in administrative burdens can be estimated proportionally. On this basis, overall **savings would amount to about EUR 95 to 320 million**, representing around two-thirds of the baseline administrative costs.

Any of the proposed changes would likely enhance legal certainty by introducing a higher degree of harmonisation. In particular, a fixed-rate deduction – especially if set at EU level – is expected to provide a clearer and more predictable framework. While stakeholders may require an initial adjustment period, the overall system would become simpler and less reliant on subjective assessments. Increased variation across borders would harm legal certainty somewhat if the rate were set at national level, but still represent an improvement compared to the current framework. In the case of an optional fixed-rate system, the gains in legal certainty may be less pronounced than under a mandatory approach, since the rules applied to each service provider would be less standardised, though still positive overall.

As for **regulatory costs for public authorities**, evidence from the targeted consultation with tax authorities suggests that the enforcement of VAT deduction rules in the financial sector generally entails **limited enforcement costs**. This aspect is the frequently identified as relatively more burdensome to enforce than other measures, but the enforcement costs still appear to be limited, which would remain the case under the baseline scenario.

Under consideration B1(i), enforcement costs for tax authorities are expected to remain broadly similar to the baseline. Clearer and more harmonised rules may marginally reduce interpretative disputes and audit effort in some cases, particularly where divergent national approaches currently create uncertainty. However, implementation would primarily involve limited one-off adjustments, such as updating national guidance, or, where relevant, adapting administrative procedures. Overall, any change in enforcement costs is expected to be modest, reflecting that baseline enforcement costs are already low in most Member States.

Under the mandatory fixed-rate variant, enforcement is expected to be further simplified, as the current range of methods used to determine deductible VAT would be replaced by the application of a single predefined rate. This is likely to reduce the scope for disputes over the allocation keys (e.g. turnover, headcount, usage metrics) used to calculate the pro rata, as well as attribution methods, and the pro-rata calculations themselves and, as a result, may reduce enforcement effort for tax administrations. Given that baseline costs are limited in most Member States, the **overall savings for public authorities are nevertheless expected to remain modest in absolute terms**.

Under the optional fixed-rate variant, similar simplifying effects would apply for those operators choosing to opt into the fixed-rate regime, while enforcement costs for operators continuing to apply proportional deduction would broadly persist. In addition, tax authorities would need to manage the coexistence of two approaches (fixed rate and proportional deduction) and the handling of associated opt-in/opt-out mechanisms. Overall, the net effect on public authority costs is therefore expected to be marginal, and dependent on the uptake of the fixed-rate option and the detailed design of the regime.

Finally, **the proposed changes are expected to cause minor benefits in the fight against VAT fraud**. Under the current rules, only a few tax authorities consider partial input tax deduction rules as problematic in terms of tax evasion and avoidance e.g., by increasing the share of costs incurring VAT allocated to taxed activities. The introduction of a fixed deduction rate, be it mandatory or optional, could further reduce the capacity for taxable operators to inflate deductible VAT, with a consequent positive effect on VAT compliance. The same dynamic would prevail to an even greater extent with the super-deduction, since this further reduces the incentives for fraud, as well as easing compliance.

12.2.5 Market impacts

Turning to impacts on market functioning, trade and competitiveness, as a starting point it is noted that, as highlighted in the problem analysis (section 9.3), the deduction rules and differences in these across

[609] Weighted average of the three industries, by demand size.

countries have not emerged as major sources of distortions or obstacles to trade. Rather, the main distortion in the financial sector arises from hidden VAT linked to exempt activities, which affects firms' cost structures and creates disincentives to outsource. As described in Section 3.1.6, Member States currently apply different approaches to proportional deduction (actual use, pro rata, general pro rata and more liberal regimes), with pro rata being the most widely used method. This diversity reflects both legal interpretation and administrative practice and contributes to variation in deduction outcomes across jurisdictions. Local rules are not the only driver of deduction rates, as other factors also contribute to explain the differences.[610] Still, **while proportional deduction methods influence deduction rates at firm level, their impact on aggregate VAT liabilities appears limited relative to the structural effects of the exemption.**[611]Under the status quo, these underlying dynamics would remain broadly unchanged.

Against this background, **the proposed policy changes focused on simplification (rather than reducing hidden VAT)**, such as greater standardisation of pro-rata methods, **would likely generate positive but limited effects on market functioning**. Reducing methodological complexity and increasing legal certainty could improve administrative efficiency and facilitate cross-border operations. However, the fact that the deduction methods are only one of several drivers of VAT burdens or administrative complexity would place a ceiling on the potential benefits. At firm level, redistribution effects would arise: operators with relatively high current deduction rates (e.g. those supplying taxable or export-oriented services) could lose, while firms primarily engaged in exempt activities could gain.

In contrast, the **impacts of the variants introducing super-deduction rates would be much more significant**. By increasing the extent to which input VAT can be recovered, these measures would directly reduce the level of hidden VAT embedded in financial services. This is particularly relevant for value chain decisions, as it would weaken the current tax-induced bias against outsourcing. Firms would be better able to organise their activities according to efficiency and innovation considerations. In turn, this could improve the overall functioning of the market and support the competitiveness of EU financial services. These effects are likely to be more pronounced in banking and asset management, where output mixes vary widely, whereas insurance activities tend to display more homogeneous structures.

Finally, an important dimension concerns the **level at which any standardisation is implemented**. National approaches would allow Member States to reflect domestic market structures but would maintain differences in outcomes across jurisdictions. An EU-wide approach would ensure formal harmonisation, yet could interact unevenly with other elements of national VAT systems (such as option to tax and VAT grouping), potentially generating other competitive imbalances.

12.2.6 Conclusions

Maintaining the status quo would preserve a stable framework but the existing shortcomings would persist. In different ways and to varying extents, these could be addressed by the changes to the deduction rules considered.

The **simplification and harmonisation assessment under consideration 1B(i)** would improve the consistency of the framework by clarifying attribution rules and establishing the pro-rata method as the default approach for mixed inputs. This option is expected to be broadly revenue-neutral and to generate some reductions in administrative costs, particularly for cross-border operators. It would also enhance legal certainty by reducing divergent national practices. However, as the core methodology for calculating deductions would remain unchanged, the scope for administrative simplification is limited.

The introduction of **fixed deduction rates based on current averages** would represent a simplification of the existing framework, reducing administrative costs and increasing legal certainty through a more standardised approach. The impacts of such a reform are expected to be relatively limited but generally positive, though the situation would vary at firm level. VAT revenue effects would likely be neutral or slightly

[610] E.g. (i) the relative shares of various 'other' financial services, which differ from country to country: (ii) the scope of exemption for certain services; and (iii) the international orientation of local institutions.

[611] Cf. Section 5.2.

positive, while firms would benefit from reduced complexity and improved predictability. Under an optional system, these gains would be more gradual and depend on uptake, with firms retaining flexibility to remain under existing rules where more favourable.

By contrast, the **introduction of a super-deduction rate** would constitute a much more substantive reform by dramatically reducing hidden VAT. This would reduce distortions in firms' value chain decisions – particularly the bias against outsourcing – and allow financial institutions to organise their activities more efficiently. As a result, this option would have a more pronounced positive impact on market functioning and competitiveness, albeit with stronger redistribution effects across firms and Member States. However, it would come at the cost of a major drop in government revenues.

Indeed, the core trade-off underlying these policy considerations is between incremental simplification, delivering modest improvements, and a more substantial reduction in hidden VAT, which would enhance market functioning but entail a loss of VAT revenues. The Table 56 below summarises the impacts of each policy consideration and variant. The impacts are each scored compared to the dynamic baseline on a five-point qualitative scale, from ++ to --, with ++ being very positive and -- being very negative; 0 means no or neutral impacts[612].

Table 56. Comparison of policy considerations

Policy consideration	Impacts on VAT revenue and sales	Impacts on legal certainty and regulatory costs	Market impacts
1B(i) Simplification of the rules	0	0/+	0/+
	Broadly revenue-neutral, with only limited and mainly transitional effects. Some redistribution may occur across Member States due to changes in deduction methods (e.g. higher deductions in actual-use countries, hence slight revenue loss EUR 1.5bn), but overall impacts remain small.	Moderate improvement through harmonisation and clearer rules. While the core calculation method remains unchanged, simplification reduces legal ambiguity, documentation burdens and cross-border complexity, leading to limited cost savings.	Slightly positive effects through reduced fragmentation and improved consistency across Member States. Redistribution across firms may occur, but overall impacts on market functioning remain modest.
1B(ii) Mandatory fixed deduction	Average deduction rate: + Super deduction rate: --	+	Average deduction rate: + Super deduction rate: ++
	Slightly positive effects on VAT revenues under average deduction rates (EUR 2 bn), and limited impact on market demand (-0.1%). Potentially significant revenue reductions under the super deduction rate (EUR -29bn), and small positive impact on market demand (+1.2%).	Considerable improvement due to the replacement of complex pro-rata calculations with a single fixed rate. This leads to substantial administrative cost savings (~EUR 135–450m/year) and a more predictable and standardised framework across the EU.	Moderate effects under the average deduction rate with some reduction on fragmentation. The super-deduction instead positively influences competitive dynamics, and reduces hidden VAT as well as the bias against outsourcing.

[612] Impacts on VAT revenues and sales are combined into a single score given the limited impacts in both respects. For instance, the positive effects on VAT revenues and limited decrease in sales estimated for consideration 1B(ii) is given a +.

	Average deduction rate: + Super reduction rate: --	0/+	Average deduction rate: + Super deduction rate: ++
1B(iii) Optional fixed deduction	Moderate effects on VAT revenues, which may increase (~EUR 7bn) under standard rates and limited impact on market demand (-0.3%). Significant decrease under super-deduction (~€-29bn), with small positive effects on sales (1.2%).	Improvement in legal certainty and cost reduction, though dependent on the level of uptake. Firms opting in benefit from simplification, while others remain under the existing system, resulting in a more gradual and partial reduction in administrative burdens (~71% uptake assumed); savings ~EUR95–320m/year.	Positive but more limited effects compared to the mandatory approach. Flexibility allows firms to choose the most suitable method, thereby mitigating distortions, while still improving efficiency and reducing hidden VAT where adopted. The super deduction rate reduces s bias against outsourcing and improves value chain efficiency

13. Building block 2: Introduction of measures to reduce non-deductible VAT for the financial sector

13.1 Policy consideration 2A – Review of VAT grouping and CSAs

Under this set of considerations, the analysis will consider the expansion or re-introduction of two VAT provisions that help financial service providers to reduce hidden VAT, especially, but not only, on intra-group supplies: **VAT grouping and CSAs**. In the financial sector, these are particularly important because VAT on internal supplies of support services, such as IT, accounting, tax, legal and back-office functions, often becomes irrecoverable under the exemption and therefore gives rise to hidden VAT.

In the current framework, **VAT grouping** is optional for Member States, with the result that its availability differs across the EU. At present, VAT groups are implemented in the large majority of Member States. Following the introduction of VAT grouping in Slovenia from 2026[613], the regime will exist in 22 Member States, leaving only five Member States without such a mechanism. Also, Article 11 provides limited guidance on how VAT grouping should be implemented and their practical operation, resulting in diverging implementation at national level. Where they are available, VAT groups allow closely bound entities to be treated as a single taxable person, with the consequence that intra-group transactions are treated as intra-company supplies and therefore fall outside the scope of VAT. VAT groups can only be formed by taxable persons established in the same Member State and hence do not cover cross-border settings.

CSAs were, and still are, used by providers of financial services to reduce the non-deductible input VAT, by setting up entities that can provide entities within the same company group or (less frequently) separate companies with VAT-exempt inputs. Typically, they are used to provide related entities with common services, including IT services, business services, as well as cleaning and other in-facility services. The five Member States currently not allowing VAT groups also do not permit CSAs, meaning these five countries (Bulgaria, Croatia, Greece, Lithuania and Romania) have neither mechanism in place for the reduction of non-deductible input VAT.

In respect to VAT grouping and CSAs, the following policy considerations are assessed:

- **Consideration 2A(i)**. **Mandatory introduction of VAT grouping**. This would extend an existing mechanism that is already widely used where available, allowing companies operating in the remaining Member States to organise their internal supplies under similar conditions.
- **Consideration 2A(ii)**. **Cross-border VAT grouping.** VAT grouping could operate on a cross-border basis within the EU, with a view to increasing its usefulness for multinational corporate groups operating across borders. Under the current wording of Article 11 of the VAT Directive, VAT groups are limited to entities established within the same Member State. Allowing cross-border VAT groups would require broader changes to the legal framework and to the administrative operation of the VAT system. In particular, mechanisms would need to be developed to ensure effective reporting of cross-border intra-group transactions, coordination between tax administrations, the treatment of VAT refund claims for expenses incurred in other Member States, and the interaction of VAT grouping with new digital reporting and electronic invoicing requirements.
- **Consideration 2A(iii). Reintroduction of CSAs**. A legislative provision could be introduced in the VAT Directive stating that CSAs can be used by providers of financial services[614], re-instating the situation which prevailed in most Member States before the 2017 judgments. This would be

[613] https://www.vatupdate.com/2025/12/20/slovenia-issues-vat-group-guidance-effective-january-2026-key-rules-and-requirements-outlined/.

[614] Or, for providers of services exempt under Article 135 of the Directive. The consequences on other industries are not explored in this analysis.

complemented by detailed norms (to be included in the VAT Directive or in the VAT Implementing Regulation) to harmonise the way CSAs are applied, specifying namely:

- Cross-border usage: the group and its members can be based in any Member State.
- Supplies to non-members: the group can provide taxed supplies to non-members.
- Activities carried out by members: members can carry out taxed activities; exempt or out-of-scope activities must represent the majority of economic activities.

- The services provided by the group to the members to be 'directly necessary' for the provision of exempt services; services of a general nature cannot benefit from the exemption[615];
  - Interaction with VAT groups: VAT groups can be members of a CSAs.
  - Interaction with transfer pricing rules: an exception should be made to transfer pricing rules (which presuppose a cost mark-up), or the mark-up should be included among the costs apportioned to members.

Table 57 below summarises the impacts considered and briefly describes the means of assessment[616]. '

Table 57. Impacts assessed for policy consideration 2A

Impact type	Overview	Means of assessment
Impacts on VAT revenue and market demand	VAT groups and CSAs reduce/eliminate VAT on intra-group supplies, reducing hidden VAT on internal support services (e.g. IT, accounting, legal, back-office). Lower hidden VAT may affect prices and demand for financial services and reduce VAT revenues. Impacts at national level vary depending on whether VAT groups / CSAs are available.	Quantitatively, based on VTTL/PEM, scenarios analysis and assumptions about the impacts on model parameters.
Legal certainty and regulatory costs	Elimination / reduction of current legal uncertainties on the use and features of VAT grouping / CSAs. Very limited changes to the regulatory costs arising from to the usage of VAT grouping / CSAs.	Quantitatively and qualitatively based on the findings of the legal analysis and the targeted consultation
Market impacts	VAT groups / CSAs facilitate the centralisation of internal support services within corporate groups by removing VAT from intra-group supplies. This impacts on business behaviour (make-or-buy decisions). Functioning of the Single Market is improved, level-playing field between domestic and multinational groups restored, addressing regulatory fragmentation.	Qualitatively based on the findings of the economic analysis and the targeted consultation

[615] This provision was in force in most Member States allowing CSAs; however, it may lead to significant complexities and national divergences. If adopted, a black-list of excluded services is to be included in a secondary act or explanatory notes.

[616] It is worth noting that the analysis is focused on the impacts from the perspective of the financial sector only, and the extent to which their use of VAT grouping and CSAs would be affected by the policy consideration. In contrast, while the legislative provisions under review could also affect other sectors, the implications for them are not assessed.

13.1.1 Impact on sales and VAT revenues

VAT grouping affects market demand and VAT revenues through its impact on irrecoverable – hidden – VAT incurred by financial service providers. **By eliminating VAT on intra-group supplies, VAT groups reduce input costs, and the savings may be partially passed on to customers in the form of lower prices**. This can in turn lead to small increases in demand for financial services. At the same time, the reduction in hidden VAT results in a decrease in VAT revenues.

CSAs are similarly used by providers of financial services to reduce the non-deductible input VAT. Their effect on the hidden VAT, hence, is very similar to that of VAT groups, with two key differences.[617]

- **The scope of VAT groups is strictly domestic; CSAs can also be used in a cross-border setting.** VAT groups make intra-group supplies out of scope of VAT but can only include entities established in the same Member State. Members of a CSA could be established in different Member States, and hence the same CSA could provide VAT-exempt inputs on a cross-border basis. This was always true in principle, though in practice the cross-border provision of VAT-exempt services via CSAs was not always possible, due to national differences in implementation. The changes considered include a harmonisation of CSAs, including the explicit permission to use them cross-border.
- **VAT groups can only be used by entities linked by financial, economic and organisational links, while CSAs can also be used by unrelated entities**. Since most of the CSAs are intra-group anyhow, this aspect is of limited relevance for most players. However, it is extremely relevant for mutual insurance companies and cooperative banks which, in some countries (e.g. Austria), are independent entities that are part of an Institutional Protection Scheme and share centralised functions, but cannot meet the criteria for forming a common VAT group. In these cases, it is CSA or nothing.[618]

In the current situation (baseline scenario), **VAT grouping already reduces hidden VAT for financial service providers** in the majority of Member States. Based on the analysis of intra-group supplies conducted in the economic analysis in Section 7.1, the reduction of hidden VAT in the 22 Member States where VAT grouping was available in the base-year of the data is estimated in the range of **EUR 4 to 16 billion annually[619]**, corresponding to approximately 0.3% to 1.2% of sectoral turnover.[620] These effects are already reflected in the current cost structures, pricing and demand patterns observed in the sector. As such, the **baseline scenario does not foresee additional changes in market demand or VAT revenues** in the Member States which have already introduced VAT groups.

Under **policy consideration 2A(i)**, the extension of VAT grouping to the remaining Member States (Lithuania, Croatia, Bulgaria, Romania and Greece) is expected to generate additional reductions in hidden VAT for financial service providers in these jurisdictions. VAT grouping is estimated to increase groupsourcing, and hence reduce taxed input costs[621], by 4 p.p.; and to reduce non-deductible input VAT

[617] Other less relevant differences were mentioned during the targeted consultation including: (i) liability, all members of a VAT group are jointly and severally liable for VAT, while this is not the case with a CSA; (ii) flexibility, members of the CSAs can be decided on an ad-hoc basis, which is not the case for VAT groups in countries which adopt an all-in approach (all linked entities must be members of the group).

[618] In certain countries, e.g. France, the issue has been addressed by introducing a legal presumption for which being part of the same Institutional Protection Scheme is assimilated as to have financial, economic and organisational links. Cf. Section 3.1.4 above.

[619] Slovenia is not considered in this analysis, as its VAT grouping regime was introduced in January 2026.

[620] Cf Section 7.1.2 for further information. Baseline year for the data is 2023, when VAT groups were available in 21 Member States, with Slovenia following suit most recently, in 2026.

[621] Measured as the share of inputs other than financial services over output value.

by 1 p.p. [622]. These two effects are used to estimate a likely range of the revenue impacts. Based on the above assumptions, impacts can be calculated based on the VTTL model[623].

Table 58 below shows the impacts for domestic settings that would arise from making VAT grouping mandatory. **The reduction of hidden VAT borne by the financial industry, and the consequent reduction of VAT revenue, would fall in a range of about EUR 570 to 670 million per year,** most of which accruing to the banking sector. Impacts concern only the five Member States which do not have VAT grouping today.

Table 58. VAT revenue impacts from mandatory availability of VAT grouping

	Banking	Insurance	Other financial services	Total
EUR mn	-540 / -460	-80 / -70	-60 / -50	-670 / -570

Source: Authors' elaboration based on VTTL

To calculate the impacts of VAT grouping on the reduction of hidden VAT in a **cross-border setting** (2A(ii)), the same approach is used. Two key differences emerge: (1) impacts concern all Member States, including those in which VAT grouping is available today; (2) the reduction of non-deductible VAT and outsourcing concerns only intra-Community supplies of goods and services other than financial services.

Table 59 below shows the revenue impacts from extending VAT groups to cross-border entities. These are larger than the more limited extension to five Member States, and **lower revenues fall in a range of EUR 9.1 to 10.6 billion per year at EU level**. Most of the impacts concern the banking sector (EUR 6.0 to 7.2 billion), but the relative impacts, as a share of current revenues, is rather similar across the three sectors.

Table 59. VAT revenue impacts from cross-border VAT grouping

	Banking	Insurance	Other financial services	Total
EUR mn	-7,200 / -6,000	-2,300 / -2,000	-1,300 / -1,100	-10,600 / -9,100

Source: Authors' elaboration based on VTTL

Revenue impacts from the **re-introduction of CSAs** (2A(iii)) are calculated starting from the impacts calculated for VAT grouping, since no separate analysis is possible[624]. The expected impacts from CSAs are lower than for VAT grouping. This is because VAT groups eliminate VAT on all intra-group supplies by treating the group as a single taxable person, thereby broadly removing hidden VAT across the full range of internal transactions. By contrast, CSAs typically apply only to specific shared inputs – most commonly back-office, IT or administrative services[625]. At the same time, CSAs retain a distinctive feature in that they can, in principle, also be used by independent or unrelated entities, such as cooperative banking networks, allowing some mitigation of VAT costs outside traditional corporate groups. Nevertheless, in practice their use remains predominantly intra-group and targeted, implying a narrower effect compared to VAT grouping in addressing hidden VAT across the value chain. To estimate the effects, scenarios were constructed based on the assumption that the domestic effects of CSAs would generate 60 to 80% of the domestic effects of VAT grouping, and 30 to 50% of the cross-border effects.

Focusing on the re-introduction of CSAs, domestic impacts are expected only in the countries that do not allow for VAT groups. The reduction of hidden VAT borne by the financial industry, and the consequent reduction of VAT revenue, would fall in a range of about EUR 340 to 540 million per year, most of which accruing to the banking sector. Another consequence of the measure considered is the harmonisation of

[622] Measured as the share of deductible input VAT over turnover.

[623] Cf description of the VTTL model in Section 5 above.

[624] Currently, in all Member States in which CSAs are available, VAT groups also are, making it impossible to distinguish the effects.

[625] In this respect, it is worth bearing in mind that several Member States formerly allowing CSAs used to exclude generic supplies.

CSAs, making explicit that they can be used also in cross-border settings. The reduction of hidden VAT, and hence of VAT revenues, from the use of CSAs in a cross-border setting would fall between EUR 2.7 and 5.4 billion per year at EU level.

Considering together domestic and cross-border impacts, **re-introducing CSAs would reduce hidden VAT, and hence VAT revenues, by EUR 3.0 to 5.9 billion.** In absolute terms, most of the benefits (about two thirds) would go to the banking sector; in relative terms, i.e. as a share of sectoral VAT revenues, impacts are almost the same across the three sub-industries.

Table 60. VAT Revenue impacts from re-introduction of CSAs (EUR mn per year)

	Banking	Insurance	Other financial services	Total
Domestic setting	-430 / -270	-60 / -40	-50 / -30	-540 / -340
Cross-border setting	-3,600 / -1,800	-1,200 / -6,00	-700 / -300	-5,400 / -2,700
Total revenue impacts	-4,000 / -2,100	-1,300 / -600	-800 / -300	-5,900 / -3,000

Source: Authors' elaboration based on VTTL

Leading from the VAT revenue reductions**, impacts on sales are expected to be positive**, because the reduction of hidden VAT is partly translated into lower prices and hence higher demand. However, **these impacts are limited**. They are largest under policy consideration 2A(ii) – introduction of cross-border VAT grouping, but, even in this case, they reach no more than 0.4% of current demand, and remain smaller under the other policy considerations.

13.1.2 Impacts on legal certainty and regulatory costs

➢ *VAT Groups*

Generally, the legal framework governing VAT groups is well established and widely used, particularly among large financial institutions. However, the discretionary nature of Article 11 has resulted in significant divergence in national implementation. Under the **baseline scenario**, the **current framework for VAT grouping would remain unchanged**. Legal uncertainty and regulatory complexity would therefore continue to stem from differences in national implementation of Article 11 of the VAT Directive, in particular regarding the interpretation of the financial, economic and organisational links required for grouping, the treatment of specific organisational structures, and the interaction with CJEU case law. These factors require businesses to assess eligibility, monitor group structures and manage compliance risks across jurisdictions, thereby generating ongoing regulatory costs.

Under **policy consideration 2A(i)**, VAT grouping would be extended to the remaining Member States (Lithuania, Croatia, Bulgaria, Romania and Greece). This option represents an extension of an existing framework rather than a change in its design. As such, **it would not significantly affect the existing sources of legal uncertainty**, as Member States would retain discretion in defining eligibility criteria and administrative procedures.

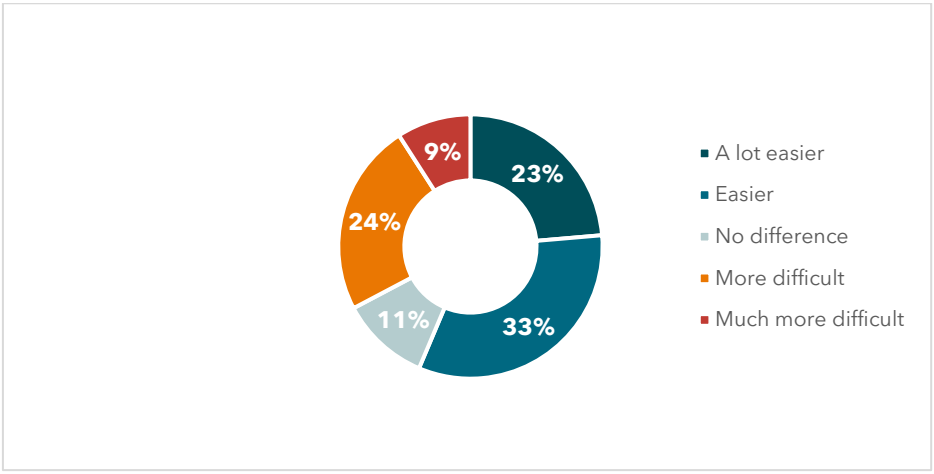
However, for **businesses in the Member States where VAT grouping is currently not available**, this consideration **would reduce administrative costs** by simplifying VAT compliance. In particular, VAT grouping eliminates the need to apply VAT to intra-group transactions and allows for the consolidation of VAT reporting at group level. Stakeholder feedback confirms that compliance is generally perceived as easier within a VAT group compared to separate VAT registration of entities.

The main drivers of these reductions include:

- the consolidation of VAT reporting into a single VAT return at group level; and
- the elimination of VAT on intra-group supplies, removing the need for invoicing and related reporting;

At the same time, VAT grouping entails certain administrative requirements, such as verifying and monitoring eligibility conditions, managing changes in group composition and consolidating VAT data. These generate both one-off and recurring costs, but available evidence suggests that they remain limited and that **administrative costs for companies operating without VAT groups are higher**[626]. This has been confirmed by stakeholders during the targeted consultation, during which a majority of respondents claimed that regulatory compliance is easier when being part of a VAT group (Figure 80 below for responses).

Figure 80. Stakeholder feedback on VAT compliance under a VAT group compared to members dealing with administration individually (Number of respondents)



Source: Authors' elaboration based on stakeholder consultation

Based on the targeted consultation, qualitative stakeholder responses have been translated into indicative quantitative ranges, suggesting that VAT grouping reduces administrative costs by approximately 1–3% of total VAT-related administrative costs. This is consistent with findings from the previous study, which concluded that both the costs and savings associated with VAT grouping are marginal relative to overall administrative costs.

Applying these assumptions to the five Member States currently without VAT grouping, and considering different uptake scenarios (25%, 50% and 75% of financial entities forming VAT groups), the **resulting cost savings remain limited in absolute terms under policy consideration 2A(i)**. Even under a high uptake and high-impact scenario (75% uptake and 3% cost reduction), total savings are estimated at around **EUR 1 million per year across the affected Member States**. At firm level, annual savings are expected to amount to a few thousand euros per entity (generally below EUR 10,000). Table 61 summarises the estimated administrative cost savings from policy consideration 2A(i).

Table 61. Administrative cost savings from introduction of VAT groups in five remaining Member States

Scenario	Uptake of VAT Groups (% of entities)	Cost saving rate (% of total VAT administrative costs saved)	Savings per smaller entity (EUR)	Savings per larger entity (EUR)	Total annual savings (EUR)
Low	25%	1%	800	2,300	120,000
Medium	50%	2%	1,600	4,500	470,000
High	75%	3%	2,400	6,800	1,000,000

[626] While some stakeholders suggested that administrative compliance can be a reason to opt for a VAT group, the primary reason for usage is the reduction of irrecoverable VAT on intra-group supplies.

Source: Authors' elaboration based on stakeholder consultation

In contrast, policy consideration 2A(iii), i.e. the introduction of cross-border VAT grouping, would constitute a fundamental change to the current framework and would raise significant challenges in terms of both legal certainty and administrative costs. While it would extend the benefits of VAT grouping to cross-border structures and could further reduce irrecoverable VAT, it would also require substantial adaptations to the VAT system, which is currently organised along national lines.

In particular, cross-border **VAT grouping would raise complex questions** regarding:

- the identification of the taxable person and the Member State responsible for administering the group;
- the allocation of VAT revenues between Member States;
- the exercise of audit and enforcement powers across jurisdictions.

Introducing cross-border VAT groups **would require significant adaptations to the existing VAT framework**. Despite this Study focuses only on the financial sector, the complexities would reverberate across all sectors, and in particular cross-border groups supplying exempt services. As highlighted in the academic literature and the case law, the current EU VAT system is based on the principle that taxable persons are administered within a single Member State. In this context, the territorial limitation of VAT grouping rules has been considered important to preserve the tax jurisdiction of individual Member States and to avoid situations where different tax authorities might adopt conflicting decisions regarding the composition or operation of a VAT group[627]. Allowing VAT groups to span several jurisdictions would therefore raise complex questions regarding the identification of the taxable person, the allocation of VAT liabilities and the jurisdiction of tax authorities. From a compliance perspective, such arrangements would require:

- enhanced reporting mechanisms for intra-group cross-border transactions;
- systems to allocate and recover input VAT across Member States;
- adaptations to existing frameworks, including electronic invoicing and intra-EU reporting;
- increased coordination between tax authorities.

These requirements would **increase administrative complexity for both businesses and tax authorities**, particularly during the implementation phase. In addition, in the absence of fully harmonised rules, **cross-border VAT grouping would likely introduce additional legal uncertainty**, as different Member States may adopt divergent approaches to the treatment and control of such arrangements.

➢ ***CSAs***

When it comes to CSAs, in the current situation, their use is affected by two types of uncertainty:

- In the six Member States which still maintained CSAs, **their use currently is in a legal limbo**, and it is unclear whether the exemption can still be justified;
- Given the diversity of implementation, **it is unclear whether CSAs can be used cross-border in practice**, even across countries that currently allow them.

Prior to the 2017 CJEU judgments that effectively removed their use by financial service providers. CSAs were used by these sectors in 19 Member States[628]. In the Member States that allowed cross-border CSAs, these could be used by multinational financial entities to organise input purchases at group-level and eliminate the VAT on intra-group supplies. Stakeholder feedback confirms that CSAs were widely used in the sector to mitigate irrecoverable VAT on shared services such as IT, compliance and back-office

[627] Advocate General's Opinion on Case C-605/15, Aviva, para. 49.

[628] Rohmer B., Luchetta, G., Poli. F., Poniatowski. G. et al, (2021) 'Review of the VAT rules for financial services, in light of the existing regulatory and other indirect taxation rules', submitted to the European Commission in January 2021. Specific Contract TAXUD/2019/DE/313 (unpublished).

processing, and were particularly important for mutual insurance companies and cooperative banks. The judgments thus disrupted previously established practices; the fact that some Member States did not implement the judgments resulted in ambiguity about the future of such arrangements.

Since the CJEU judgments of 2017, 13 Member States have removed CSAs for use in sectors other than those providing supplies exempt *ex* Art. 132 (cd. 'social services'), while six continue to allow them[629]. The problem definition found that these divergent approaches are sending mixed messages about the future of CSAs, contributing to a sense of limbo and legal uncertainty. While awaiting a resolution at EU level, service providers have delayed business decisions (e.g. on whether to form VAT groups) while some tax authorities have avoided removing CSAs or introducing VAT groups. Stakeholder consultations also indicate that the resulting legal fragmentation has generated uncertainty for both businesses and tax administrations, with some Member States maintaining legacy arrangements while others removed them entirely. This problem results not from the availability or absence of CSAs, but from a lack of clarity about their future. **The lack of clarity would be alleviated over time by both the prohibition and re-introduction of CSAs**.

Under the dynamic baseline, the uncertainty would dissipate as CSAs are progressively removed throughout the EU. In this scenario, it is likely that, in the countries in which VAT groups are available, most of the companies currently using CSAs would avail themselves of the VAT group regime instead. **This would entail some one-off administrative costs to wind up existing CSAs and to set up VAT groups**; stakeholders indeed report that the transition towards VAT grouping would generally involve manageable one-off organisational adjustments. Switching to VAT groups would not be possible in the following cases: (i) for financial service providers established in Member States which have not introduced VAT grouping; (ii) for multinational groups which used the CSAs to provide services cross-border; and (iii) for entities that are not linked by economic, financial and organisation entities (in particular, mutual insurance companies and cooperative banks).

Reintroducing CSAs (2A(iii)) and making them available throughout the EU would also eliminate the legal uncertainty about the future of the arrangement. With clear provisions in EU law stating that CSAs are allowed for providers of financial services, tax authorities would be able to draft or reinstate corresponding national legislation and guidance. This would ensure that companies could establish and rely on CSAs with confidence about their long-term viability, obviating the need to pursue alternative approaches to avoid regulatory risk. From a regulatory cost perspective, **this measure generates no administrative costs,** as the decision to avail oneself of a CSA remains voluntary for financial services providers. However, companies choosing to establish or participate in a CSA would still incur the associated setup and administrative costs.

Another existing area of uncertainty concerns discrepancies in how they are applied across Member States, in terms of aspects like the scope of eligible activities and availability or not for cross-border use. The **proposed legislative measure to reintroduce CSAs is also designed to reduce this uncertainty considerably**. Mainly, the benefits would stem from making CSAs universally available and explicitly allowing for their use cross-border. In addition, this measure would harmonise the modalities for CSA implementation in the most relevant areas where there had previously been discrepancies. The proposed modalities would, for the most part, follow the previous majoritarian national approaches and Commission guidance aimed at reducing frictions with the pre-existing frameworks. Attention should also be paid to the coordination with transfer pricing rules, as discussed in more detail in Box 22 below. Hence, instead of dealing with a fragmented regulatory landscape, multinational providers of financial services would be able to use this tool consistently to manage centralised services and reduce hidden VAT. By specifying implementation modalities in detail, the measure would prevent Member States from permitting CSAs only nominally while imposing conditions that make them nearly impossible to use in practice – as has occurred in certain Member States to date.

[629] Cf. Legal analysis in Section 3.1.

Box 22. Coordination between CSAs and transfer pricing rules

A few stakeholders suggested, during the targeted consultation, that the interaction between CSAs and transfer pricing rules could create inconsistencies. The identified complexity would not stem from CSAs per se, but from the need to reconcile two frameworks with different objectives and logics. In practice, this creates uncertainty as to how to design cross-border CSAs that are simultaneously compliant with VAT exemption conditions (notably cost-based recharges), and defensible under transfer pricing rules (arm's length remuneration and value-based allocation). Addressing this aspect is necessary to ensure that CSAs can safely be used for cross-border supplies of services.

The main sources of tension include[630]:

1. **Tension between "at cost" reimbursement and arm's length pricing.** CSAs typically rely on a pure cost-reimbursement model, i.e. members recharge costs without a margin. This is central to the VAT exemption logic (no "consideration" beyond cost sharing). By contrast, transfer pricing rules generally require that intra-group transactions be priced at arm's length, which often implies a mark-up for services (e.g. cost-plus for support functions). This creates a structural mismatch: what is required for VAT exemption (no margin) may be questioned under direct tax rules. The absence of a margin in CSAs can be challenged from a transfer pricing perspective, especially where: (i) the entity performing the services assumes functions or risks that would normally justify a profit element; (ii) tax authorities consider that a service provider is effectively carrying out an economic activity rather than merely sharing costs.
2. **Allocation keys and consistency with value creation.** CSAs require allocating shared costs among participants based on pre-determined allocation keys (e.g. turnover, headcount, usage metrics). For VAT purposes, the key requirement is that allocations reflect members' share of the joint activity. Transfer pricing, however, requires that allocations reflect value creation and actual benefits received. Differences arise when: (i) allocation keys are simplified proxies (e.g. equal split, broad turnover metrics); (ii) benefits are difficult to measure, especially for shared services like IT platforms or compliance functions. This can lead to disputes on whether the allocation methodology is sufficiently aligned with arm's length principles.

Increased audit and dispute risk in cross-border situations. Complexity can be amplified by the fact that VAT and transfer pricing are typically enforced by different authorities, often with limited coordination. This increases the likelihood of double adjustments, disputes, and legal uncertainty, which stakeholders could perceive as a significant barrier to the practical use of cross-border CSAs.

➢ *Tax authorities*

Under the status quo, tax authorities administer VAT grouping regimes in the majority of Member States. G When asked during the targeted consultation, tax authorities generally considered VAT groups to cause negligible enforcement costs. Subsequently, the introduction of VAT grouping in the remaining Member States under **policy consideration 2A(i) is not expected to lead to significant enforcements costs**. Having said that, the establishment and management of procedures to monitor VAT group eligibility, composition and compliance would likely result in minimal one-off and recurring enforcement costs. At the same time, VAT grouping may reduce certain administrative burdens by decreasing the number of taxable persons and VAT returns to be processed, as reporting is consolidated at group level. Overall, the impact on tax authorities is expected to be limited, as similar systems are already in place in most Member States.

The introduction of **cross-border VAT groups (policy consideration 2A(ii)) would have more significant implications for tax authorities**. In particular, it would require **enhanced administrative cooperation** between Member States to ensure effective control over group structures spanning multiple jurisdictions. This would include the exchange of information on group members, coordination of audits and the development of mechanisms to monitor cross-border intra-group transactions.

Additional complexity would arise in relation to the **allocation and recovery of input VAT**, as well as ensuring consistent treatment of transactions across Member States. Implementing such arrangements would likely require adaptations to existing reporting systems and administrative procedures, including the development of mechanisms to track transactions that are no longer subject to VAT but remain relevant for control purposes.

Furthermore, cross-border VAT grouping would raise additional challenges related to the risk of tax avoidance and distortions within the Single Market. In particular, tax authorities would need to monitor

[630] Cf. *i.a.* OECD (2022), Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

potential incentives for businesses to organise VAT groups in Member States with more favourable deduction or taxation regimes, as well as ensure that VAT grouping is not used to facilitate profit shifting or to circumvent rules applicable to SMEs and partially exempt businesses. Addressing these risks would require enhanced data exchange between Member States and additional administrative resources. In conclusion, **cross-border VAT grouping is expected to increase administrative complexity and enforcement costs for tax authorities**, particularly in the short to medium term.

The re-introduction of CSAs (policy consideration 2A(iii)) would also entail additional enforcement costs for tax authorities, although these are expected to remain moderate overall. In Member States where CSAs are currently not allowed or not applied to the financial sector, tax authorities would need to establish new administrative procedures to assess eligibility conditions, monitor compliance with the "at cost" requirement, and ensure that the exemption is not used in a way that distorts competition. Additional efforts would arise in the context of cross-border CSAs, notably in verifying the correct treatment of services supplied between members located in different jurisdictions and in coordinating interpretations of the applicable conditions. However, compared to cross-border VAT grouping, these challenges are likely to be less demanding, as CSAs present lower coordination and administration challenges compared to cross-border VAT grouping. Overall, enforcement costs associated with CSAs can therefore be expected to fall between those associated with policy consideration 2A(i) (mandatory VAT grouping) and 2A(ii) (cross-border VAT grouping).

13.1.3 Market impacts

When it comes to market impacts of VAT grouping and CSAs, two aspects are to be considered:

1. **The effect of CSAs on make-or-buy decisions**[631], because of the impacts on hidden VAT on input supplies;
2. How changes to the regime for VAT grouping and CSAs affects the **Single Market for financial services**.

➢ *Make-or-buy decisions*

The effects of VAT grouping and CSAs on make-or-buy decisions need to be assessed against the broader distortions created by VAT exemptions without the right to deduct. As highlighted in the economic analysis of the current situation[632], irrecoverable VAT on inputs affects firms' sourcing decisions, creating a structural bias towards in-house production. However, for company groups consisting of separate entities, in-house production can still generate hidden VAT on intra-group supplies. VAT grouping and CSAs interact directly with this mechanism by mitigating non-deductible VAT on centralised inputs. By favouring centralisation at group level, they allow achieving economies of scale and specialisation for shared services (e.g. IT supplies, business services), reducing their costs.

Under the current framework, VAT grouping and CSAs contribute to certain distortions in value chains and competitive conditions, albeit to a limited extent. By removing VAT on intra-group supplies, they create an incentive for vertically integrated firms to internalise services that might otherwise be outsourced. This can disadvantage independent service providers, including SMEs, which typically lack the scale to replicate such functions in-house and must therefore rely more heavily on taxable third-party inputs. Moreover, SMEs are themselves suppliers of outsourced services in the value chains of the financial sector. The need to charge VAT on these services makes them relatively expensive compared to similar services provided within a VAT group.

Mandatory VAT grouping (2A(i)) or the re-introduction of CSAs (2A(iii)) under a harmonised EU framework would reduce hidden VAT, and hence VAT-induced market distortions, by lowering the cost of shared inputs. This would favour groupsourcing relative to outsourcing, as highlighted by both the

[631] That is, the decision by a company to produce an intermediate input internally (make) or to obtain it from third parties on the market (buy).

[632] Cf. Section 7.1 above.

economic analysis and stakeholder feedback, and would thus allow for the VAT-exempt centralisation of service provision at group level. With either option, this effect would be most pronounced in Member States where neither VAT grouping nor CSAs are currently available,[633] as these jurisdictions would experience the largest reduction in hidden VAT following the introduction of either mechanism. As mentioned above, this measure would favour large groups, which are more able to centralise and insource shared functions, than SMEs, especially in specific market segments which cannot access VAT grouping (cooperative banks, mutual insurance companies).

The broader scope and flexibility of CSAs compared to VAT grouping would enable more diverse organisational forms, including cooperation between independent entities. This effect would be relevant for all Member States with a significant presence of mutual insurance companies and cooperative banks.[634]

Finally, cross-border VAT grouping (2A(ii)) and the explicit possibility to use CSAs in a cross-border setting (under 2A(iii)) would also allow groupsourcing for cross-border entities. These consequences, albeit similar in nature, are discussed more in detail below under Single Market effects.

- ***Single market effects***

The implications of re-introduction of CSAs (2A(iii)) for the Single Market are particularly relevant. They concern both the level-playing field between domestic and multinational groups, as well as between financial providers established in different Member States.

Under the current framework, the **availability and design of VAT grouping and CSAs differ across Member States**, contributing to fragmentation within the Single Market. In particular, businesses operating in Member States in which VAT grouping or CSA is not available cannot benefit from the reduction in hidden VAT to the same extent as competitors elsewhere. Moreover, national regimes vary in their design and application, including differences in eligibility criteria, administrative procedures, and whether VAT grouping is optional or automatic, which can affect the ease of use and accessibility of these mechanisms across jurisdictions.

Importantly, in the current situation, when it comes to non-deductible VAT on intra-group supplies, domestic groups of financial services providers established in countries in which VAT grouping is allowed face a more favourable VAT treatment compared to multinational groups. Domestic groups can eliminate non-deductible VAT via VAT grouping; due to the territorial limitations of VAT groups, multinational groups cannot, and, in the current situation, CSAs are currently hardly usable to this purpose. This runs contrary to the objectives of the SIU to promote a Single Market for financial services.

Under **policy consideration 2A(i)**, all Member States would be required to allow VAT grouping, thereby extending the existing framework to the remaining five Member States. This would contribute to restoring a more level playing field across Member States, although differences in national implementation (e.g. eligibility criteria or administrative procedures) may persist and continue to generate some degree of divergence. The extension of VAT grouping would also extend the existing incentives for internalisation of services to these Member States. However, as these dynamics are already present in the majority of Member States where VAT grouping is available, and given the limited number of jurisdictions affected, the **overall impact on market structures**, including on outsourcing and SMEs, **is expected to remain limited**.

Under the policy consideration on **cross-border VAT grouping (2A(ii))**, VAT groups would be opened to include entities established in different Member States, which would represent a more fundamental change. Allowing cross-border VAT grouping would remove this distinction and **improve VAT neutrality** for multinational groups, thereby **supporting a more integrated Single Market**. It would also simplify the VAT treatment of intra-group transactions across jurisdictions, including in situations affected by the

[633] Bulgaria, Croatia, Greece, Lithuania and Romania. In Slovenia, which also do not allow for CSAs for financial service providers, VAT groups have been introduced from 2026.

[634] E.g. Austria, Germania, Italy, the Netherlands, France, Spain (the significance of problem in these Member States differ depending on the specific company structure and applicable provisions).

Skandia and Danske Bank case law[635], which has introduced complexity in the treatment of cross-border intra-entity supplies.

However, cross-border VAT grouping could **give also rise to certain risks related to differences in national VAT systems**. In particular, where Member States apply different rules on input VAT recovery, there may be incentives for businesses to organise group structures in a way that maximises recovery, for instance by centralising certain functions or costs in jurisdictions with more favourable deduction regimes. While such effects would not alter the place of taxation of final consumption, they could influence the allocation of activities within groups and create perceived distortions within the Single Market. Problems could also concern VAT groups spanning across Member States in which grouping is mandatory or optional for group entities. Addressing these risks would likely require appropriate safeguards and coordination between Member States.

Similarly, **the re-introduction of CSAs (2A(iii)) would redress this distortion.** By harmonising the most important implementation choices, the re-introduction of CSAs is expected to eliminate some of the discrepancies and barriers to their usage which had emerged prior to the CJEU judgments. Discrepancies in the rules for applying CSAs had previously acted as a barrier to this practice, causing certain companies to organise CSAs (and thus source input supplies) domestically for regulatory reasons. The harmonisation of the implementation modalities, in particular when it comes to the cross-border usage of CSAs, would greatly reduce the existing barriers to the centralisation and sharing of functions across Member States. This could facilitate more integrated EU-wide operating models for financial institutions, in line with broader policy objectives to deepen the Single Market for financial services.

Results from the targeted consultation showed that the current rules put multinational organisations at a disadvantage compared to purely domestic groups when it comes to intra-group supplies. In this context, both cross-border VAT grouping and CSAs (if allowed cross-border) are seen as a tool to restore a more level playing field between domestic and multinational structures. At the same time, stakeholders' views suggest that cross-border implementation would need to be carefully designed, as practical and legal complexities remain. Some respondents noted that while cross-border CSAs could solve existing problems, they may also introduce uncertainty if not supported by clear and consistent rules. Nonetheless, there is broad agreement that the current lack of workable cross-border solutions contributes to Single Market fragmentation.

13.1.4 Conclusions

The three policy considerations under Policy Area 2A reduce hidden VAT, hence lowering VAT revenues and redressing some of the existing market distortions. Similarly, they foster the level-playing field for financial service providers established in different Member States. Within those broadly similar impacts, they differ in terms of the magnitude of their impacts, their scope, their complexity, as well as the extent to which they contribute to the Single Market for financial services.

Mandatory VAT grouping (policy consideration 2A(i)) represents a limited extension to five more Member States of an already widely used mechanism. The overall reduction in hidden VAT – and the corresponding loss in VAT revenues – is relatively modest, estimated at around EUR 570–570 million annually. Its impacts are concentrated in the five Member States where VAT grouping is currently not available, and, therein, they can reach almost 20% of the current sectoral VAT revenues. Administrative cost savings for businesses are limited in absolute terms, with total annual savings estimated at up to EUR 1 million under high uptake scenarios, reflecting reductions of around 1–3% of VAT-related administrative costs for the affected entities. Impacts on market structure and the Single Market are positive but limited, as the measure mainly aligns a small number of Member States with an already prevailing framework.

Cross-border VAT grouping (policy consideration 2A(ii)) entails a much more substantial change to the VAT system and correspondingly larger impacts. By extending VAT grouping across Member States, it

[635] Judgment of the Court of 17 September 2014, *Skandia America Corp. (USA), filial Sverige*, C-7/13, EU:C:2014:2225; Judgment of the Court of 11 March 2021, *Danske Bank A/S, Danmark, Sverige Filial v Skatteverket,* C-812/19,ECLI:EU:C:2021:196.

significantly enhances the ability of multinational groups to eliminate hidden VAT on intra-group supplies, restoring similar competitive conditions compared to domestic groups. This results in a sizeable reduction in VAT revenues, estimated at EUR 9.1 – 10.6 billion annually, with broadly similar proportional effects across banking, insurance and other financial services. While the measure delivers the strongest improvements in VAT neutrality and Single Market integration, it also entails the highest regulatory complexity. In particular, it requires complex adaptations to the VAT system, including new mechanisms for allocating taxing rights, coordinating audits, and managing cross-border compliance. As a result, it represents the most impactful but also the most administratively demanding option.

The impacts of the **re-introduction of CSAs (policy consideration 2A(iii))** on hidden VAT and VAT revenues are significant but more limited than cross-border VAT grouping, reflecting the narrower and more targeted scope of CSAs. The total reduction in VAT revenues is estimated at EUR 3.0 – 5.9 billion annually (around 3–5% of sectoral VAT revenues), combining both domestic and cross-border effects. Unlike VAT grouping, CSAs apply primarily to specific shared inputs rather than all intra-group supplies, which structurally limits their impact. At the same time, their potential use by independent entities – such as cooperative banks and mutual insurers – broadens their relevance beyond traditional corporate groups. From a regulatory perspective, the re-introduction of CSAs would generate limited additional administrative and enforcement costs, as participation remains voluntary. Similar to cross-border VAT grouping, their re-introduction would significantly enhance the ability of multinational groups to eliminate hidden VAT on intra-group supplies, restoring similar competitive conditions vs. domestic groups, without the associated regulatory and legal complexity.

The Table 62 below summarises the impacts of each policy consideration and variant. The impacts are each scored compared to the dynamic baseline on a five-point qualitative scale, from ++ to --, with ++ being very positive and -- being very negative; 0 means no or neutral impacts[636].

Table 62. Policy comparison: 2A - Review of VAT grouping and CSAs

Policy consideration	Impacts on VAT revenue and market demand	Impacts on legal certainty and regulatory costs	Market impacts
2A(i). Mandatory introduction of VAT grouping.	0/-	+	+
	Reduction of VAT revenues: EUR 570–670 million. Impacts occurring only in the 5 Member States in which VAT grouping is not available (LT, HR, BG, RO and EL): up to -20% of national sectoral VAT revenues Limited positive impacts on demand for financial services	No additional complexity or uncertainty Administrative cost savings for businesses: EUR 1 mn Negligible increase in enforcement costs	Reduction of hidden VAT favours centralisation and outsourcing Limited flexibility can be a disadvantage for small financial service providers, cooperative / mutual groups Financial services providers can use VAT grouping in all MS No redress of the distortion between domestic and cross-border groups
2A(ii). Cross-border VAT grouping.	--	--	+/++
	Reduction of VAT revenues: EUR 9.1-10.6 billion.	Significant increase in complexity and legal certainty due to the	Reduction of hidden VAT favours centralisation and outsourcing in multinational groups

[636] As with block 1, for block 2 impacts on VAT revenues and sales are combined into a single score given the limited impacts on sales.

	Limited positive impacts on demand for financial services	administration of cross-border VAT groups Moderate increase in enforcement costs	Limited flexibility can be a disadvantage for small financial service providers, cooperative / mutual groups Redress of the distortion between domestic and cross-border groups
2A(iii). Reintroduction of CSAs.	-/--	+	++
	Reduction of VAT revenues: EUR 3.0-5.9 billion. Limited positive impacts on demand for financial services	Harmonisation of CSA requirement and implementation modalities reduces complexity Negligible increase in enforcement costs	Reduction of hidden VAT favours centralisation and outsourcing in multinational groups Flexibility reduces disadvantage for small financial service providers, cooperative / mutual groups Redress of the distortion between domestic and cross-border groups

13.2 Policy consideration 2B: Mandatory option to tax for Member States

13.2.1 Introduction

Article 137(1)(a) of the VAT Directive allows Member States to introduce an option to tax for the supply of financial services listed in Article 135(1)(b) to (g). Nine Member States make use of the option to tax for the provision of financial services[637]. Member States are free to determine the conditions governing the exercise of the option, in particular with respect of the financial services covered by the option (i.e. whether all supplies listed in Article 135(1)(b) to (g) or only a subset), and whether the option is to be exercised on a comprehensive basis, i.e. for all supplies made by one taxable person, or on a transactional basis, i.e. the taxable person can choose whether opting in for each supply. The provision of insurance and insurance-related services covered by Article 135(1)(a) is excluded from this optional regime.

The policy considerations in this area analyse the impacts of making the option to tax mandatory for Member States, while maintaining optionality for taxable persons. Four different variants, in terms of scope and approach, are considered and namely:

- **Consideration 2B(i): Narrow, comprehensive.** A mandatory option to tax is introduced for the financial services listed in Article 135(1)(b) to (g); the option to tax must be exercised at entity level and applies to all supplies of financial services;
- **Consideration 2B(ii): Narrow, transactional.** A mandatory option to tax is introduced for the financial services listed in Article 135(1)(b) to (g); the option to tax can be exercised on a transaction-by-transaction basis;
- **Consideration 2B(iii): Broad, comprehensive.** A mandatory option to tax is introduced for the financial services listed in Article 135(1)(b) to (g) as well for insurance and insurance related services covered by Article 135(1)(a); the option to tax must be exercised at entity level and applies to all supplies of financial services;

[637] Austria, Belgium, Bulgaria, Croatia, Estonia, France, Germany, Lithuania, and Poland.

- **Consideration 2B(iv): Broad, transactional.** A mandatory option to tax is introduced for the financial services listed in Article 135(1)(b) to (g) as well for insurance and insurance related services covered by Article 135(1)(a); the option to tax can be exercised on a transaction-by-transaction basis.

In all cases, the measures would clarify that the option to tax could be used also for cross-border transactions. To accommodate for this change, the place of supply rules should be shifted to the country of destination (i.e. customers' residence or establishment); the One-Stop-Shop (OSS) could be used to remit VAT on qualifying supplies. Other aspects of the regime (e.g. how to apply / register for use of the option, whether the participating suppliers should be 'locked in' for a number of years) could be harmonised or left at Member States' discretion.

Table 63 provides for the type of impacts considered in the analysis. Since the considerations concern the introduction of VAT on a portion of the financial services market, the methodology mimics the one carried out for Block 3 in Chapter 14 below. However, impacts are significantly lower, and the analysis is adapted accordingly. In particular, it relies on the PEM and does not employ the macroeconomic model, which is suitable for larger, structural variations in revenue and market impacts. Similarly to what discussed for Block 3, no environmental impacts or consequences on fundamental rights are expected.

Table 63. Impacts assessed for policy consideration 2B

Impact type	Overview	Means of assessment
Impacts on VAT revenue and sales	The option to tax affects VAT revenues and prices through its impact on irrecoverable ('hidden') VAT and on the taxation of outputs. Sales impacts follow to the extent to which increase in / reduction of tax burden is passed on to customers.	Quantitatively assessed using the VTTL framework and PEM[638]. based on scenario analysis (uptake rates, scope, and behavioural assumptions). Results estimated at EU level by sector (banking, insurance, other financial services) and in total.
Market impacts	The option to tax reduces hidden VAT and thereby affects pricing and sourcing decisions. It improves VAT neutrality by reducing distortions. The measure contributes to a more level playing field within the Single Market, especially where current availability differs across Member States and where cross-border provision is affected by unrecoverable VAT.	Qualitative assessment based on the economic analysis of current distortions and stakeholder consultation.
Impacts on legal certainty and regulatory costs	The introduction or expansion of the option to tax is not expected to create significant legal uncertainty. Introducing the option to tax may increase regulatory costs for businesses and tax authorities.	Qualitative and quantitative assessment based on stakeholder evidence (from the targeted consultation) and legal analysis.

[638] Cf introduction to Part C.

13.2.2 Methodology

The analysis of the policy considerations concerning the option to tax has been done by means of an extension of the PEM. This represents an improvement compared to the previous study, since at that time the PEM could not be applied to the more specific VAT provisions examined under this policy consideration[639].

A key parameter for the analysis is the likely uptake of the option to tax by financial institutions. **This is subject to a high degree of uncertainty**, since evidence from the targeted consultation is scant and at times inconsistent, as discussed below in Box 23.

In the absence of robust empirical evidence, the analysis follows a **scenario-based approach.** Rather than relying on a single estimate of uptake, the analysis considers a range of potential scenarios, reflecting different degrees of adoption of the option to tax across the financial sector. Uptake is measured in terms of the share of market activity covered, proxied by the value of supplies subject to VAT following the exercise of the option. The specific values have been selected considering (i) the evidence from the targeted consultation; (ii) the analysis of the targeted consultation in the previous study; and (iii) the relation between the expected uptake under the entity-level and transaction-by-transaction approaches (discussed below). Finally, the levels have been selected to provide meaningful analytical results, i.e., to cover a broad range of possible uptakes.

A key determinant of uptake is the design of the option to tax, in particular whether it can be applied on a transaction-by-transaction basis or only at the level of the entity:

- Under a **transaction-by-transaction approach (2B(ii) and 2B(iv))**, the modelling assumes that financial institutions are able to target the option at supplies made to taxable customers with the right to deduct. This implies a relatively high degree of flexibility and, consequently, a higher potential uptake. In this case, uptake scenarios can be directly interpreted as the share of B2B supplies (to fully deductible customers) that become taxable (and hence give rise to the right to deduct related input supplies).
- By contrast, under an **entity-level approach (2B(i) and 2B(iii))**, a service provider must apply the option also to transactions with private consumers, with public authorities and with businesses without the right to deduct. This reduces its attractiveness and is expected to lead to a significantly lower uptake. In particular, only company whose client base is significantly skewed towards providing financial services to businesses with the right to deduct would find the option profitable, and opt in. In the absence of strong empirical evidence, the analysis adopts a simplifying assumption whereby uptake is much lower for the entity-level approach, at 25% of the uptake assumed for the transaction-based approach.

The scenarios considered are shown in Table 64 below. For the transactional approach, a full uptake (100%) scenario is also considered as an upper bound, primarily to illustrate the maximum potential effects of the reform, particularly under more flexible implementation modalities. Full implementation is not realistic under an entity-specific approach, because of the impacts on the other market segments[640].

Table 64. Uptake scenarios for the option to tax analysis

	Transaction-by-transaction	Entity-specific
Low	10%	2.5%
Moderate	22%	5.5%

[639] To compensate for this, in the previous study a bottom-up approach was used. A standard financial provider was designed, considering the fiscal data collected from financial service providers participating to the targeted consultation, which was then used to simulate in which cases a bank would opt for taxation. The top-down approach used in this study relies on sectoral data at national level, rather than inferring results from the sample of respondents.

[640] Besides, full uptake of the entity-specific option to tax would correspond to the policy consideration 3a – full taxation.

High	40%	10%
Full	100%	n.a.

Source: Authors' elaboration

Across all considerations and scenarios, options are modelled based on the place of supply of transactions being in the country of destination (i.e. customers' residence or establishment), subject to the use of OSS and reverse charge whenever possible.

The analysis also allows for differences in the **scope of application** of the option to tax, distinguishing in particular between:

- a narrow scope, limited to core financial services (banking and asset management), and
- a wider scope, including insurance services.

While this distinction does not directly affect the definition of uptake scenarios, it is relevant for the interpretation of the results, as it determines the overall market base to which the uptake rates are applied

Overall, the chosen methodology is designed to provide a transparent and flexible framework for assessing impacts under different policy considerations. The use of multiple uptake scenarios is particularly important given that the magnitude of revenue and sales effects depends critically on the extent of adoption of the option to tax. The use of different scenarios thus represents a **sensitivity analysis** of the most consequential analytical parameter.

Box 23. Evidence on the uptake of the option to tax from the targeted consultation

Evidence from the targeted consultation on the uptake of the option to tax is **fragmented and, at times, inconsistent across respondents**, making it difficult to derive a single robust estimate of current or future adoption. On the one hand, several stakeholders report **low or negligible use** of the option in certain Member States or segments, often due to restrictive design features (e.g. global application at entity level), lack of flexibility, or high compliance risks. On the other hand, in jurisdictions where the option is more flexible – particularly when it can be applied on a **transaction-by-transaction basis** – the uptake appears more significant and targeted, especially for B2B transactions with fully taxable customers. Still, even in those countries, the adoption may be uneven across different type of financial service providers. For instance, in Germany, cooperative and savings banks are reported to make relatively extensive use of the option for selected services, whereas private banks tend to opt in less frequently due to high implementation costs and operational complexity.

13.2.3 Impact on sales and VAT revenues

The estimated impacts on VAT revenues and sales vary significantly across policy considerations, primarily reflecting differences in the design of the option to tax (entity-level vs transaction-based) and in its scope (financial services only vs inclusion of insurance). Overall, results are driven by the extent to which the option allows financial institutions to reduce 'hidden VAT', and by the corresponding increase in deductible input VAT.

Under **entity-level approaches** (Considerations 2B(i) and 2B(iii)), the introduction of a mandatory option to tax leads to an **increase in VAT revenues**. This reflects the fact that taxation is applied broadly, including to transactions with non-deductible customers, thereby generating additional output VAT, which is typically higher than the non-deductible VAT saved on B2B transactions.

- Under **Consideration 2B(i) (narrow scope, entity-level)**, VAT revenues increase by approximately **EUR 0.6 billion** under low uptake, rising to around **EUR 2.3 billion** in the high uptake scenario.
- Under **Consideration 2B(iii) (broad scope including insurance, entity-level)**, the impact is more pronounced, with increases ranging from about **EUR 1.6 billion** to **EUR 6.4 billion**, reflecting the larger tax base. Impacts are relatively larger for the insurance industry, because of higher share of B2Csupplies.

By contrast, under **transaction-based approaches** (Considerations 2B(ii) and 2B(iv)), VAT revenues **decrease**, as financial institutions selectively apply VAT to transactions with business customers with the right to deduct, maximising input VAT recovery while limiting additional output VAT.

- Under **Consideration 2B(ii) (narrow scope, transactional)**, VAT revenues are estimated to decrease by around **EUR 2.2 billion** in the low uptake scenario, reaching approximately **EUR 8.9 billion** in the high uptake scenario. Under full uptake – the upper impact bound if all service providers opted in, revenue impacts would reach up to EUR 22.1 billion. Impacts are relatively larger for the other financial services sector, because of the relative higher weight of B2B transactions.
- Under **Consideration 2B(iv) (broad scope including insurance, transactional)**, the decrease is larger, ranging from approximately **EUR 2.9 billion** to **EUR 11.6 billion.** Under full uptake – the upper impact bound if all service providers opted in, revenue impacts would reach up to EUR 28.7 billion. Impacts are relatively larger for the other financial services sector, because of the relative higher weight of B2B transactions.

Overall, the results highlight a clear contrast: **entity-level options tend to increase VAT revenues**, while **transaction-based options lead to revenue losses**, with the magnitude of the effect strongly dependent on uptake and scope. In particular, the inclusion of insurance services within the scope of the option significantly increase the fiscal costs of the reform (+50% for the transactional scenarios, more than double in the comprehensive ones). Full results are shown in Table 65, Table 66, and Table 67.

Table 65. VAT revenue impacts from the option to tax – Low uptake scenario

EUR bn	Banking	Insurance	Other financial services	Total
2B(i): Narrow, comprehensive	0.5	-	0.1	0.6
2B(ii): Narrow, transactional	-1.6	-	-0.7	-2.2
2B(iii): Broad, comprehensive	0.6	0.8	0.2	1.6
2B(iv): Broad, transactional	-1.6	-0.6	-0.7	-2.9

Source: Authors' elaboration based on PEM. Note. 10% uptake for transactional option to tax, 2.5% uptake for comprehensive option to tax.

Table 66. VAT revenue impacts from the option to tax – Medium uptake scenario

EUR bn	Banking	Insurance	Other financial services	Total
2B(i): Narrow, comprehensive	1.2	-	0.1	1.3
2B(ii): Narrow, transactional	-3.5	-	-1.4	-4.9
2B(iii): Broad, comprehensive	1.4	1.8	0.4	3.5
2B(iv): Broad, transactional	-3.5	-1.4	-1.4	-6.4

Source: Authors' elaboration based on PEM. Note. 22% uptake for transactional option to tax, 5.5% uptake for comprehensive option to tax.

Table 67. VAT revenue impacts from the option to tax – High uptake scenario

EUR bn	Banking	Insurance	Other financial services	Total
2B(i): Narrow, comprehensive	2.2	-	0.2	2.3
2B(ii): Narrow, transactional	-6.3	-	-2.6	-8.9
2B(iii): Broad, comprehensive	2.6	3.2	0.6	6.4
2B(iv): Broad, transactional	-6.4	-2.6	-2.6	-11.6

Source: Authors' elaboration based on PEM. Note. 40% uptake for transactional option to tax, 10% uptake for comprehensive option to tax.

Across all policy considerations, the estimated impacts on sales are very limited, remaining well below 1% of current sales even in the highest uptake scenarios[641]. More in detail:

- Under entity-level approaches, sales effects are generally close to zero or marginally negative, reflecting slight increases in prices for non-deductible customers (B2C and certain B2B segments).
- Under transaction-based approaches, sales effects are slightly positive, driven by the partial pass-through of hidden VAT savings to business customers. However, even in high uptake scenarios, these effects remain modest (below 0.5% of current sales).

Overall, the option to tax is not expected to have a material impact on aggregate sales volumes in the financial sector. Its effects are instead primarily redistributive, affecting the allocation of VAT burdens between suppliers, business customers, and final consumers, rather than the overall level of economic activity. Given the limited magnitude of the impacts on demand, no significant impacts are expected on the price of financial services, the price of non-financial goods and services, or access to financial products by disadvantaged consumers.

13.2.4 Impacts on legal certainty and regulatory costs

Where applicable, the option to tax regime is generally perceived by both private operators and tax authorities as conceptually clear, and stakeholder feedback does not point to systematic problems in terms of legal certainty. In particular, the current application of the option to tax has not raised concerns when it comes to state aid rules. This assessment is not expected to change under the policy considerations analysed. On the contrary, stakeholders consider that extending and harmonising the option to tax at EU level, by reducing legal fragmentation across Member States, would improve predictability.

Evidence from the targeted consultation suggests that legal certainty is closely linked to the degree of flexibility embedded in the system. In particular, regimes requiring the option to be exercised at entity level (2B(i) and 2B(iii)) have been perceived as clearer. By contrast, a transaction-by-transaction approach (2B(ii) and 2B(iv)) tends to add complexity, as firms must assess and document the VAT treatment at the level of individual transactions, including verifying the status of customers. This is especially the case when not only the status of the customer is to be verified, but also the use of services (as in Germany). This aspect could be simplified by removing the duty to monitor the use of services on financial service providers; if the taxable person uses the services for private consumption, him/herself would be liable for the VAT incorrectly deducted.

[641] This is due partly to the assumption of relative inelasticity of demand used in the partial-equilibrium model, as explained in the overview of the model introduction to Part C. If demand for financial services turn out to be more elastic than estimated, greater movements in sales would be foreseen.

The inclusion of insurance services (2B(iii) and 2B(iv)) introduces an additional dimension. While the extension of the option to tax to insurance is not expected to fundamentally alter the legal logic of the provision, it may increase the need for clarification in areas where the boundaries of exempt insurance services are already subject to interpretation (e.g. ancillary services, intermediation, or bundled products). In this respect, the broader scope may initially give rise to interpretative questions and require additional guidance from tax authorities, particularly in Member States with limited experience in taxing such services. Over time, however, a harmonised framework could reduce the current diversity of national practices and associated uncertainty.

In terms of regulatory costs, stakeholder feedback consistently indicates that **the option to tax entails non-negligible administrative costs for private operators, primarily concentrated at the implementation stage**. These one-off costs include the adaptation of IT systems, changes to accounting and invoicing processes, contractual adjustments with clients, and staff training. In several cases, these investments are described as substantial, sometimes requiring "complex interventions in IT and processes" and significant upfront expenditure before any benefits materialise[642]. These administrative costs are expected to limit uptake of the option to tax, with financial services providers foregoing the additional input tax deduction in exchange of a simpler, more uniform treatment of output supplies, as it is already the case in the Member States in which the option is available.

Such costs are expected to arise under all policy considerations, but their magnitude will depend on the design of the option. Under entity-level approaches (2B(i) and 2B(iii)), ongoing administrative burdens are likely to be lower ongoing operations, as the VAT treatment is applied uniformly across all supplies. However, the all-or-nothing nature of the decision may require more extensive system-wide one-off efforts, including company or entity separation to discriminate the markets. Conversely, under transaction-by-transaction approaches (2B(ii) and 2B(iv)), one-off administrative costs may be more limited, but ongoing administrative costs are expected to be higher. Firms must continuously identify eligible transactions, verify customer status (including changes over time), and ensure correct application and documentation of the option. Insurance service providers (under options 2B(iii) and 2B(iv)) are likely to face higher one-off costs, reflecting the need to adapt systems and processes in a sector where VAT has traditionally not been applied to outputs.

Enforcement costs for public authorities are generally considered limited under the current regime, and no evidence suggests that they would increase significantly under the policy considerations. Some additional costs may arise in the short to medium term due to higher uptake, including the need to issue guidance, monitor compliance, and resolve interpretative issues, particularly in Member States with no prior experience of the option or in relation to newly covered services such as insurance. However, these costs are expected to stabilise over time as practices become standardised.

Litigation and dispute resolution costs are currently perceived as low and not directly attributable to the option to tax. Under the policy considerations, a moderate increase in disputes cannot be excluded, especially in the initial phases of implementation and in areas requiring interpretation (e.g. determination of the tax base for complex financial products). Nonetheless, given the existing evidence from Member States with the option to tax, these risks are expected to remain limited and to decrease over time as case law and administrative practice develop.

13.2.5 Market impacts

The introduction of a mandatory option to tax across Member States would affect competitive conditions within the financial and insurance sectors, firms' sourcing decisions, and the functioning of the Single Market. The direction of changes is similar across the four policy considerations, although their magnitude would likely increase if the supplies of insurance services are included (2B3 and 2B4) and under the transactional approach (2Bii) and 2B(iv)).

[642] These costs could not be quantified because the few banks participating with the targeted consultation which had experience with the option to tax could not provide quantitative estimates, also considering that those costs were typically incurred several years ago.

The magnitude of the impacts is too limited to significantly improve the international competitive position of EU financial service providers – also considering that local subsidiaries of non-EU entities could benefit from the same regulatory conditions. Furthermore, the considerations at stake are not expected to affect the transmission of monetary policy, for which no evidence of interactions or problems could be retrieved from the Member States which currently apply the option to tax.

- ***Impact on the level-playing field***

The option to tax affects the level playing field by altering the share of taxable outputs, and hence the amount of non-deductible input VAT borne by suppliers, and in turn their effective cost structure. Firms applying the option incur less hidden VAT, resulting in higher input VAT recovery and, depending on competitive conditions, either higher margins or lower prices. **This introduces different competitive conditions on the market between companies that decide to opt for VAT or not**.

This distortion is not unfair per se: under the measures considered, any supplier of financial services will be able to decide whether to opt in or not, at the same conditions as any other operator in the EU, and for any of the financial (and insurance) services provided. Still, the decision to opt depends on the nature of the supplier, their input cost structure, their market segments, their propensity to exports.

In particular, financial service providers with a business model predominantly oriented towards business customers with a right to deduct are more likely to opt for taxation, as this allows them to recover input VAT without adversely affecting their clients. By contrast, suppliers with a larger share of B2C or exempt customers (e.g. retail banking or life insurance segments) may have weaker incentives to opt, especially under entity-level approaches, as the application of VAT on outputs could increase final prices and affect demand. Similarly, countries with a higher share of extra-EU exports, which is zero-rated today, would, on average, find less benefit from opting for VAT.

As a result, the option to tax would lead to some differentiation in effective tax burdens and pricing across firms depending on their customer mix. This could translate into moderate shifts in competitive positions within the sector, with B2B-oriented providers benefiting more. Still, these changes reflect the removal of existing distortions linked to irrecoverable VAT rather than the introduction of new asymmetries, and are therefore consistent with the objective of improving VAT neutrality.

Considering detailed policy choices, the transactional approach allows every provider to opt in, regardless of how limited their B2B customer base is, despite the advantages being greater the larger the B2B share. Opting firms are expected to achieve higher deduction rates than non-opting competitors, particularly where input costs are significant. This may confer a competitive advantage in B2B markets, reflected in lower tax-inclusive costs and potentially more competitive pricing. However, this advantage is not discriminatory, as all operators would have access to the option under harmonised EU rules.

By contrast, under the entity-level approach (2B(i) and 2B(iii)), the option would apply to all supplies, including those made to non-taxable or partially taxable customers. While this increases input VAT recovery, it also requires charging VAT on outputs to consumers and businesses without a right to deduct. This would discourage service providers with a large B2B customer bases from opting in, comparatively increasing the magnitude of the distortion between B2B- and B2B-oriented companies. The inclusion of insurance services within the scope would also increase the magnitude of the impacts, given that the customer base depends on the type of insurance policies sold by each company.

Still, under the current framework, these distortions are limited in practice. The economic analysis[643] shows that (i) the proportion of taxable outputs is very similar in countries with or without the option to tax; (ii) the transactional approach increases the proportion of taxable outputs by about 1 p.p.; and (iii) in countries which have introduced the option to tax recently (i.e., Poland), the share of taxable output has increased more than total turnover, but remains very low. This is likely due to the relatively low uptake, particularly where it must be applied at entity level, and the fact that, in several Member States, the option to tax is only available for a small subset of financial services. Evidence from stakeholders indicates that,

[643] Cf. Section 7.1.1 above.

while the option can improve deduction rates, it has not so far been a major driver of competitive advantage, largely because its design often limits its effective use and because implementation costs can be significant. **Under the policy considerations assessed, the impact on the level-playing field would likely become more pronounced, albeit still differentiated across options**.

Overall, while the introduction of a mandatory option to tax would lead to some differentiation in effective tax burdens across firms depending on their uptake and business models, these differences reflect the removal of existing distortions rather than the creation of new ones. The effects are expected to be most visible under transaction-based options and when the scope includes insurance, but are unlikely to lead to significant or disruptive shifts in market structure.

➢ *Impact on outsourcing and organisational choices*

The option to tax directly affects firms' sourcing decisions by addressing one of the main distortions created by the VAT exemption, namely the disincentive to outsource due to irrecoverable input VAT. As highlighted in the economic analysis[644], the exemption increases the tax-inclusive cost of externally procured inputs, thereby favouring in-house provision even where outsourcing would be more efficient. **By allowing suppliers to tax (part of) their outputs and recover more input VAT, the option to tax reduces the outsourcing distortion.** Hence, external services – such as IT, data processing, compliance, or back-office functions – become relatively cheaper compared to in-house provision, improving the efficiency of production and enabling greater specialisation.

The strength of this effect depends again on the design of the option:

- Under the transaction-by-transaction approach (2B(ii) and 2B(iv)), the removal of outsourcing disincentives is expected to be substantial because of a higher uptake. In other words, the distortion is going to affect a lower number of financial service providers (those which are not going to opt in), and the decrease hidden VAT – in aggregate – is going to be larger. Under the entity-level approach (2B(i) and 2B(iii)), the effect is more limited, as the incentive to reorganise production and increase outsourcing is weaker and would concern fewer operators.
- Extending the option to insurance services (2B(iii) and 2B(iv)) would amplify these effects, as insurers rely extensively on outsourced services (e.g. claims management, IT, actuarial services) and currently face significant irrecoverable VAT. In this context, the option to tax could facilitate more efficient allocation of functions both within and across firms.

Finally, **the benefit is going to be proportionately more significant for smaller entities**. Irrecoverable VAT tends to penalise business models that rely more heavily on externally sourced inputs, which are more common among smaller financial service providers. Similarly, SMEs working in the supply chains of financial service providers may benefit from more outsourcing. Larger institutions, by contrast, are often better able to internalise functions or rely on group structures to mitigate hidden VAT, thereby benefiting from a structural advantage.

Overall, the introduction of the option to tax is expected to reduce the current bias towards insourcing and support more efficient organisational structures, with the strongest effects arising under transaction-based approaches and broader sectoral coverage.

➢ *Impact on the Single Market*

The proposed measures also improve the functioning of the Single Market. Under the current framework, the option to tax is characterised by a high degree of fragmentation: it is available only in some Member States, its scope and conditions vary considerably, and its application to cross-border transactions is often restricted and may even be impossible when the supply is concern customers from a Member State which did not opt in. This results in an uneven playing field across the EU,

[644] *Ibid.*

Making the option to tax mandatory and available in all Member States, for a harmonised set of services, would ensure equal access to this regime across the EU. This would eliminate differences in treatment stemming from the location of the supplier and contribute to a more level-playing field between suppliers of financial services established in different Member States. Secondly, it would also eliminate the risk of distorting the price of financial services for business customers varies across Member States because of the uneven implementation of the option; this impact is unlikely to be of a significant magnitude.

In addition, the reform would allow the application of the option to cross-border transactions. This would allow firms opting-in to apply the same VAT treatment to domestic and intra-EU supplies, also reducing legal uncertainty and compliance complexity in cross-border operations. The benefits are expected to be particularly relevant for multinational financial groups and for service providers operating across multiple Member States. To ensure that this does not come with additional compliance burdens for cross-border suppliers and to reduce distortions from difference in VAT rates, this measure should be coupled with the following provisions: (1) the place of supply of the transaction is in the country of destination, i.e. consumer's residence or customer's establishment; (2) B2B supplies should be subject to mandatory reverse charge; and (3) for B2B supplies, the use of OSS should be made possible.

The extent to which the reform leads to greater harmonisation in practice depends on the degree of discretion left to Member States in implementing the option. A more standardised design – particularly with respect to scope and modalities – would further reduce fragmentation and administrative costs.

As regards economic outcomes, the impact on the volume of cross-border trade in financial services is expected to remain limited. These services are still predominantly supplied in domestic markets, due to regulatory, linguistic, and customer proximity factors. However, the reform would improve the conditions for cross-border provision, hence increasing cross-border trade and support the broader objective of deepening the Single Market for financial services.

13.2.6 Conclusions

The impacts of the policy considerations related to the option to tax differ depending on the design of the regime, notably the degree of flexibility in its application (transactional vs. comprehensive) and the scope of services covered (with or without insurance services). Across all options, the mechanism operates by modifying the current balance between output taxation and input VAT recovery, thereby affecting VAT revenues, market functioning, and regulatory costs.

In terms of VAT revenues, the direction of the effects varies across the policy considerations:

- **Options based on an entity-level application increase VAT revenues**, as taxation is applied more broadly, including to transactions with customers not entitled to deduct input VAT. If insurance services remain outside from the option to tax regime, revenue increase is estimated at EUR 0.6-2.3 billion per year at EU level This effect becomes more pronounced when the scope is extended to insurance services, given the size of the sector and the importance of final consumption (EUR 1.6-6.4 billion per year at EU level).
- **By contrast, transaction-based approaches are associated with reductions in VAT revenues.** In these cases, taxable persons can apply VAT selectively to supplies made to customers with full deduction rights, increasing input VAT recovery while limiting additional output VAT. As a result, hidden VAT is reduced without a corresponding increase in taxable outputs. Across all options, the impact on sales remains limited. If the option is limited to banking and other financial services, VAT revenues are estimated to decrease by approximately EUR 2.2-8.9 billion; when extended to insurance services, the reduction is larger, in the range of EUR 2.9-11.6 billion.

Changes in aggregate sales remain below one percent, due to the incomplete transmission of tax burdens to customers.

The effects on market functioning reflect similar trade-offs. **All policy considerations contribute to reducing irrecoverable VAT and, to some extent, the distortions associated with the exemption**. This tends to improve the neutrality of VAT, particularly in B2B transactions. **Transaction-based approaches**

are more closely aligned with this objective, as they allow taxation to be applied where it does not create additional costs for customers, thereby reducing cascading effects in supply chains. Entity-level approaches, by extending taxation to all transactions, also affect supplies to other customers, which may lead to higher prices in some segments and partially offset the gains in neutrality observed elsewhere. Extending the option to tax to insurance services increases consistency across financial activities, although the market implications become more visible in markets where final consumption plays a larger role.

From a Single Market perspective**, all policy considerations contribute to reducing the current fragmentation in the availability and design of the option to tax across Member States**, thereby restoring a more consistent level playing field for financial institutions operating in different jurisdictions. Making the option to tax available across all Member States would therefore reduce distortions, ensuring that similar activities can be structured under comparable VAT treatment across the Union. This is particularly relevant for cross-border business models, where differences in VAT treatment can currently create additional administrative costs and legal uncertainty.

Importantly, **the harmonised framework would also allow for a more effective use of the option in cross-border transactions**, enabling financial institutions to apply VAT in a consistent manner when supplying services across Member States. This would help mitigate the accumulation of hidden VAT in cross-border supply chains and reduce competitive disadvantages for firms operating on a pan-European basis.

The impacts on legal certainty appear limited across the policy considerations. The option to tax is already part of the existing framework and is generally well understood where implemented. Adjustments to its scope or modalities do not fundamentally alter its nature, although clarifications at EU level could reduce uncertainty in some areas. All policy considerations entail non-negligible one-off administrative costs for businesses, in particular linked to changes in IT systems, internal processes, and staff training. These costs tend to increase with the breadth of the regime, for example where insurance is included. Ongoing administrative costs are more sensitive to the design of the option. Transaction-based approaches require more granular assessments at the level of individual transactions, including the identification of customer status and the adaptation of invoicing and reporting systems. Entity-level approaches are simpler to operate in this respect, as they avoid transaction-level differentiation, but this comes at the expense of reduced flexibility. For tax authorities, the introduction or expansion of the option to tax implies additional monitoring and control activities, especially where application depends on transaction-level conditions. These efforts remain limited overall and are likely to be somewhat higher under more flexible regimes.

The Table 68 below summarises the impacts of each policy consideration and variant. The impacts are each scored compared to the dynamic baseline on a five-point qualitative scale, from ++ to --, with ++ being very positive and -- being very negative; 0 means no or neutral impacts[645].

Table 68. Policy comparison: 2B Option to tax

Policy consideration	Impacts on sales and VAT revenues	Market impacts	Impacts on legal certainty and regulatory costs
	+	0/+	-
2B(i). Narrow (without insurance), comprehensive	Higher VAT revenues: EUR 0.6-2.3 billion per year at EU level Marginal negative effects on sales.	Distortions are reduced in banking and other financial services markets, but at the cost of higher tax burden of B2C supplies Option to tax becomes available in all MS under similar conditions; it can be used for cross-border transactions	Less flexible entity-based approach reduces increase in administrative costs for businesses (especially recurring costs) and enforcement costs for tax authorities.

[645] As with block 1, for block 2 impacts on VAT revenues and sales are combined into a single score given the limited impacts on sales.

2B(ii). Narrow (without insurance), transactional	-	+/++	--
	Lower VAT revenues: EUR 2.2 –8.9 billion Marginal positive effects on sales.	Distortions are reduced in banking and other financial services markets. Option to tax becomes available in all MS under similar conditions; it can be used for cross-border transactions	More flexible transactional approach results in more significant increase of administrative costs for businesses (especially recurring costs) and enforcement costs for tax authorities.
2B(iii): Broad (with insurance), comprehensive	++	+	-
	Higher VAT revenues: EUR 1.6-6.4 billion per year at EU level Marginal negative effects on sales.	Distortions are reduced across all markets, but at the cost of higher tax burden of B2C supplies Option to tax becomes available in all MS under similar conditions; it can be used for cross-border transactions	Less flexible entity-based approach reduces increase in administrative costs for businesses (especially recurring costs) and enforcement costs for tax authorities.
2B(iv): Broad (with insurance), transactional	--	++	--
	Lower VAT revenues: EUR 2.9-11.6 billion Marginal positive effects on sales.	Distortions are reduced across all markets. Option to tax becomes available in all MS under similar conditions; it can be used for cross-border transactions	More flexible transactional approach results in more significant increase of administrative costs for businesses (especially recurring costs) and enforcement costs for tax authorities.

14. Block 3: Revisiting the VAT exemption for financial services and introduction of harmonisation measures in sectoral taxes

14.1 Introduction

In contrast with the incremental changes explored in the foregoing chapters, this third block assesses the likely impacts of fundamental reforms to the tax framework for the financial sector. Three policy considerations are assessed.

The first **two considerations entail removing the VAT exemption, either for all financial services (3A), or only for financial services remunerated by fees and commissions (3B)**. These two policy considerations are closely related conceptually and practically, and thus are analysed together in Section 14.2. As explained in Section 11.4, three variants are assessed in each case, namely:

- Considerations 3A(i)a and 3B(i)a: application of standard VAT rates, coupled with the removal of sectoral taxes to avoid double taxation[646];
- Consideration 3A(i)b and 3B(i)b: application of standard VAT rates, with sectoral taxes retained[647];
- Consideration 3A(ii) and 3B(ii): application of VAT rates designed to maintain current taxation levels (revenue neutral rates), with sectoral taxes retained.

Within these variants, the assessment also explores the possibility of retaining the exemption for basic banking services and pension funds, as a means for ensuring the affordability of these for consumers.

For **consideration 3B on removing the VAT exemption only for fee-based services**, for the economic models used to estimate the impacts it was necessary to define the relevant share of sectoral turnover that would be taxed. For banking, this was done based on data provided directly from the European Banking Authority, which was used to determine the relevant shares of interest-based and fee-based turnover for each Member State; at EU level, this averages to about 73% of turnover from interest-based services, and the remaining 27% from fee-based services. For insurance and other financial services, all sectoral turnover is assumed to be fee-based (and thus taxed under consideration 3B). Importantly, for consideration 3B(i)a, the removal of sectoral taxes for modelling purposes is proportionate to the turnover concerned, meaning the tax revenues from these taxes would fall to zero in the insurance and other financial services sectors, while for banking a portion of the relevant taxes would continue to be applied.

Policy consideration 3C (Section 14.3) comes at reform from another angle. **It would zero-rate financial services from a VAT perspective while introducing a Financial Activities Tax (FAT)**, defined as a tax on the sum of companies' profits and remuneration (i.e., the added value). Instead of attempting to integrate the financial sector into the VAT system, this potential policy change would remove it as a generator of VAT revenues, and offset the revenue loss with the FAT, thereby aiming to achieve the economic effects of VAT while addressing the practical difficulties. To avoid double-taxation and simplify the tax framework, this consideration would also include the removal of sectoral taxes currently applied at national level. In line with the policy objectives centred on the functioning of the tax system (rather than on increasing tax revenue), the assessment uses FAT rates which have been calibrated to achieve revenue neutrality compared to the current situation. Consideration 3C also includes two additional harmonisation measures, namely the removal of the transitional measures on the Capital Duty Directive (CDD), and coordination of sectoral taxes with a non-binding Commission Recommendation. These do not comprise a full policy consideration, but rather are complementary measures that could be implemented separately or as complements to a wider policy package.

[646] As explained in Section 11.4, for the purpose of the analysis the removal of sectoral taxes for variants 3A(i)a and 3B(i)a encompasses all of the sectoral taxes identified and analysed for the study, namely taxes on the sale of financial services products (including IPTs), FTTs, financial institution levies, payroll taxes, additional CIT and windfall taxes.

[647] 3A(i)b and 3B(i)b are unlikely to be politically or practically feasible due to the significance of associated tax increase. Nonetheless, they provide a useful point of comparison as a 'pure' approach to removing the VAT exemption without any changes to the national taxes that remain in the national competence.

The **legal mechanisms** for implementing the policy considerations in this block are as described in Section 11.1. Specifically, for Considerations 3A and 3B, revisions to the scope of exempt supplies in Article 135 of the VAT Directive would serve to eliminate or reduce the scope of the exemption for financial services. For the variants of 3A and 3B including the removal of sectoral taxes, for IPTs this would be achieved through an amendment to Article 401 on other taxes, duties and charges, while the introduction of an FAT for Consideration 3C would be done with a dedicated legislative initiative.

Certain variants of Consideration 3A and 3B, and Consideration 3C, also include the removal of other sectoral taxes. Due to the national competence for taxation, **these taxes could not be removed by legislative action at EU level and instead would rely on soft law, in the form of a Commission Recommendation**. While the practical impacts on Member State governments of such a Recommendation are difficult to determine, for the purpose of the analysis it is assumed that the recommended tax changes would in fact be implemented and that the desired level of tax harmonisation would be achieved.

The table below outlines the types of impacts that are assessed for the policy considerations in this block. These are structured in terms of five broad categories, which in turn form the headings of the ensuing sections. For the economic impacts estimated with the partial-equilibrium and macroeconomic models, the results presented in this chapter are supplemented with more detailed data tables in Volume 2, Annex 5.

Aside from the impact types listed, the policy considerations were also **screened for further second-order environmental impacts[648] or on fundamental rights[649]**. Given the scale of the estimated impacts on the financial sector, the fact that none of the considerations make distinctions based on factors relevant to these areas, distant nature of any interactions and fact that no respondents to the targeted consultation raised particular concerns, it appears unlikely that any noticeable impacts in these areas could be expected.

Table 69. Impacts assessed for Block 3

Impact type	Overview	Means of assessment
Impacts on sales and tax revenues	The policy considerations in this block entail fundamental reforms to the tax framework for financial services in terms of both tax treatment and tax rates. As such, it is important to test the impacts on the core first-order impacts of sales of (i.e., demand for) financial services and tax revenues. The partial-equilibrium model is used for this purpose, with results broken down by sector and market segment (B2B vs B2C), while the macroeconomic model is used to test the second-order impacts.	Quantitative – mainly partial-equilibrium model
Macroeconomic impacts	Tax reforms of a structural nature could also be expected to generate macroeconomic impacts. The macroeconomic model is used to test the impacts in terms of GDP components (GDP, final consumption, investment and the trade balance with third countries)	Quantitative – macroeconomic model

[648] The considerations have been screened against the environmental dimensions identified in the Commission's Better Toolbox #36, including consistency with the 'do no significant harm' principle, the objectives of the European Green Deal and climate neutrality, direct and indirect environmental impacts (including non-EU effects), incentives for cleaner production or consumption (e.g. polluter-pays-based or market-based instruments such as ETS), the need for mitigation and adaptation measures, life-cycle and circular-economy considerations, the prevention of future environmental damage, and the EU's leverage on the environmental practices of trading partners. As a measure concerning indirect taxation concerning the VAT treatment of financial services – which are intangible and not associated with material resource use, emissions or other environmental pressures – the considerations do not interact with any of these dimensions in a meaningful way and neither support nor undermine the achievement of the Green Deal objectives.

[649] The policy considerations have been screened against the dimensions identified in the Commission's Better Regulation Toolbox #29i, i.a., against potential differential or discriminatory impacts on grounds of sex, racial or ethnic origin, religion or belief, disability, age and sexual orientation and compliance with the UN Convention on the Rights of Persons with Disabilities. The considerations do not target or differentiate between any of these groups and are not expected to influence existing inequalities on these grounds. No relevant impact has therefore been identified.

	and employment (distinguishing between high- and low-skilled jobs), considering both non-recycling and recycling scenarios.	
Impacts on legal certainty	The problem analysis identified a number of issues with legal certainty under the current situation, most of which stem from the nature of the exemption and the complex arrangements needed to implement it (e.g., proportional deduction rules). The structural reforms in this block would aim to address these, either fully or partly. However, any improvements need to be weighed against new challenges that would arise, such as to define the tax base for interest-based services (for Consideration 3A), avoid uncertainty between taxed and exempt services (Consideration 3B), or adjust to a new form of taxation (Consideration 3C).	Mostly qualitative
Impacts on regulatory costs	The procedural aspects of the current tax framework entail administrative costs for businesses and enforcement costs for tax authorities. In particular, compliance with the VAT exemption was found to be costlier for businesses than normal VAT compliance. The reforms assessed in this block would include simplifications that are expected to generate savings (e.g., from the reduced need to calculate proportional deductions) which are compared with the costs of additional requirements (e.g., for VAT invoicing). The impacts on regulatory costs are assessed using the standard-cost model.	Mostly quantitative – standard cost model
Market impacts	Structural reforms to the tax framework could be expected to have a wide range of impacts on the functioning of the market for financial services. These include intended benefits like the reduction or elimination of market distortions caused by the VAT exemption and improved conditions for innovation and digitalisation and trading cross-border in the EU. They also include risks like the potential for new distortions, e.g., between taxed and exempt services under Consideration 3B, and knock-on effects on competitiveness. The impacts on larger providers vs SMEs are important to examine. In consideration 3A, the application of VAT to interest-based services also creates a need to assess the implications for monetary policy and the transmission of interest-rate changes.	Mostly qualitative
Social impacts	The assessment of social impacts considers two main aspects. First, Considerations 3A(i) and 3B(i) may have upward impacts on the costs and therefore affordability of certain financial services. The assessment therefore includes financial inclusion in terms of access to basic banking services, pension investment and housing credit. Second, as a proxy for distribution impacts, the macroeconomic model allows for the estimate of employment impacts on high- vs low-skills jobs.	Mostly quantitative

14.2 Policy considerations 3A and 3B: Removal of the exemption and IPTs

14.2.1 Impacts on sales and tax revenues

➢ *First-order impacts on sales of financial services (partial-equilibrium model)*

Based on the model, the removal of the VAT exemption combined with (for variants 3A(i)a and 3B(i)a) the removal of sectoral taxes leads overall to **limited changes in total demand for financial services**, regardless of whether the reform applies to all services (Consideration 3A) or only to fee-based services (Consideration 3B). Across all variants examined, the total impact on sales remains within a range between -3% and +5% of current sales, corresponding to changes of between approximately EUR -11 billion and EUR +15 billion. This suggests that, even with a relatively high assumed pass-through rate of 80% and a moderate assumed demand elasticity of -0.5, **first-order impacts on total sales are visible but remain moderate** relative to the size of the financial services sector. This is because, in the model, sales respond mainly through the price channel: changes in effective taxation are passed through to prices only partially, and the resulting price changes affect demand according to the assumed elasticity. The relatively high pass-through rate and moderate demand elasticity used in the core scenario therefore show that changes in tax treatment translate into visible, though still moderate, changes in sales.

When applying VAT at **standard rates to all financial services combined with the removal of all sectoral taxes (Consideration 3A(i)a)**, the model estimates a positive impact on total sales of around +2%, corresponding to approximately EUR +13 billion. This reflects the interaction between two opposing mechanisms: on the one hand, the introduction of VAT on outputs increases prices and tends to reduce demand; on the other hand, the removal of 'hidden VAT' and sectoral taxes reduces production costs and exerts downward pressure on prices. In aggregate, the reduction in production costs more than offsets the upward effect of output VAT on prices, leading to a net increase in total sales.

By contrast, when standard-rate VAT is introduced while sectoral taxes are maintained (Consideration 3A(i)b), the impact on demand becomes negative overall (around EUR –11 billion). In this case, the upward price effects associated with the introduction of VAT are no longer offset by reductions in sector-specific taxation, particularly in the insurance sector, where demand declines most markedly (-3%).

As would be expected, **the revenue-neutral variant (Consideration 3A(ii))**, under which VAT rates are calibrated so as to leave government revenues broadly unchanged while sectoral taxes are maintained, **leads to almost no measurable change in total demand**. By design, the calibrated VAT rates result in only limited changes in effective prices.

Table 70. Total impact on sales of removing the VAT exemption and removing or maintaining sectoral taxes, as % of current sales and in EUR billion (partial equilibrium)

Impact on sales of removing the VAT exemption and removing or maintaining sectoral taxes	Impact (B2B + B2C)				
	As % of current sales				EUR bn
	Banking	Insurance	Other financial services	Total	Total
3A(i)a – VAT on all services, standard rates, removal of all sectoral taxes	<1%	3%	5%	2%	13
3A(i)b – VAT on all services, standard rates, sectoral taxes maintained	-1%	-3%	3%	-1%	-11
3A(ii) – VAT on all services, revenue-neutral rates, sectoral taxes maintained	<1%	-1%	4%	<1%	<1
3B(i)a – VAT on fee-based services, standard rates, proportional removal of sectoral taxes	1%	3%	5%	2%	15
3B(i)b – VAT on fee-based services, standard rates, sectoral taxes maintained	<1%	-3%	3%	-1%	-7
3B(ii) – VAT on fee-based services, revenue-neutral rates, sectoral taxes maintained	<1%	<1%	1%	<1%	<1

The results for **Consideration 3B**, under which VAT is applied only to fee-based services, follow the same overall pattern with similar to slightly smaller magnitude. When applying **standard VAT rates to fee-based services together with the removal of all sectoral taxes (Consideration 3B(i)a)**, the impact on total sales is positive (around +2%, corresponding to approximately EUR +15 billion).

When sectoral **taxes are maintained under the standard-rate scenario (Consideration 3B(i)b**), the impact becomes slightly negative overall (-1%, at around EUR –7 billion), reflecting the more limited scope of the VAT base and the persistence of sectoral tax burdens. Under the **revenue-neutral variant (Consideration 3B(ii))**, the impact on sales is again negligible.

The results can also be broken down so that the impacts on B2B and B2C segments can be examined separately. For the **B2B segment**, all scenarios lead to **moderate but consistently positive effects on demand**. The largest increases are observed under the scenarios combining VAT reform with the removal of all sectoral taxes (Considerations 3A(i)a and 3B(i)a), where sales increase by around +3% (approximately EUR +14 billion). These positive effects are observed across all three sectors and are primarily driven by the **introduction of full input VAT deductibility together with the removal of sectoral taxes**, which reduces input costs for business users and lowers the effective price of financial services in B2B transactions.

When sectoral taxes are maintained, the positive effects on B2B demand become smaller but remain positive overall (EUR +3 billion to EUR +4 billion). Under the revenue-neutral variants (**Considerations 3A(ii) and 3B(ii)**), sales increase slightly (EUR +6 billion and EUR +2 billion respectively). Overall, the B2B results reflect the fact that most business users are able to deduct VAT on inputs, thereby limiting the upward price effect associated with the taxation of outputs.

Table 71. B2B impact on sales of removing the VAT exemption and removing or maintaining sectoral taxes, as % of current sales and in EUR billion (partial equilibrium)

Impact on sales of removing the VAT exemption and removing or maintaining sectoral taxes	Impact on B2B segment				
	As % of current sales				EUR bn
	Banking	Insurance	Other financial services	Total	Total
3A(i)a – VAT on all services, standard rates, removal of all sectoral taxes	1%	7%	9%	3%	14
3A(i)b – VAT on all services, standard rates, sectoral taxes maintained	<1%	<1%	5%	1%	3
3A(ii) – VAT on all services, revenue-neutral rates, sectoral taxes maintained	1%	1%	6%	1%	6
3B(i)a – VAT on fee-based services, standard rates, proportional removal of sectoral taxes	1%	7%	9%	3%	14
3B(i)b – VAT on fee-based services, standard rates, sectoral taxes maintained	<1%	<1%	5%	1%	4
3B(ii) – VAT on fee-based services, revenue-neutral rates, sectoral taxes maintained	<1%	<1%	2%	<1%	2

In contrast, the **B2C segment** shows more **heterogeneous and generally weaker first-order impacts**. Under the standard-rate scenarios combined with the removal of all sectoral taxes (**Considerations 3A(i)a and 3B(i)a**), the overall impact on demand is broadly neutral, with total changes close to zero: approximately EUR -1 billion under Consideration 3A(i)a and EUR +2 billion under Consideration 3B(i)a. These results reflect the fact that, for final consumers, the introduction of VAT on outputs tends to increase prices, while the removal of hidden VAT and sectoral taxes broadly offsets this effect.

When standard-rate VAT is introduced while sectoral taxes are maintained (**Considerations 3A(i)b and 3B(i)b**), the B2C segment experiences a more marked decline in sales, estimated at around -3% overall, corresponding to approximately EUR -14 billion and EUR -11 billion, respectively. In these cases, final consumers face higher effective taxation without benefiting from reductions in sector-specific taxes. Under the revenue-neutral variants, the overall impact on B2C demand remains close to zero, although modest

negative effects persist in the insurance sector and to a lower extent in the banking sector, again reflecting the low elasticity of household demand and the incomplete pass-through of tax changes to final prices.

Table 72. B2C impact on sales of removing the VAT exemption and removing or maintaining sectoral taxes, as % of current sales and in EUR billion (partial equilibrium)

Impact on sales of removing the VAT exemption and removing or maintaining sectoral taxes	Impact on B2C segment				
	As % of current sales				EUR bn
	Banking	Insurance	Other financial services	Total	Total
3A(i)a – VAT on all services, standard rates, removal of all sectoral taxes	-2%	2%	-2%	<1%	-1
3A(i)b – VAT on all services, standard rates, sectoral taxes maintained	-3%	-4%	-2%	-3%	-14
3A(ii) – VAT on all services, revenue-neutral rates, sectoral taxes maintained	-1%	-2%	1%	-1%	-5
3B(i)a – VAT on fee-based services, standard rates, proportional removal of sectoral taxes	-1%	2%	-2%	<1%	2
3B(i)b – VAT on fee-based services, standard rates, sectoral taxes maintained	-1%	-4%	-2%	-3%	-11
3B(ii) – VAT on fee-based services, revenue-neutral rates, sectoral taxes maintained	<1%	-1%	<1%	<1%	-1

- ***First-order impact on tax revenues (partial-equilibrium model)***

The results indicate that reforms combining changes to the VAT exemption with modifications to sectoral taxes lead to **substantial changes in government revenues**, with the direction and magnitude of the effect depending primarily on whether sectoral taxes are removed or maintained. This reflects the fact that government revenues are affected first and foremost by changes in the effective tax base and applicable tax rates, including whether sectoral taxes are removed or maintained. By comparison, the indirect revenue effect arising from changes in the quantity of services supplied is smaller, because demand responses operate only through the pass-through and elasticity channel.

Looking first at the total impact (B2B and B2C combined), the application of VAT at standard rates to all financial services combined with the removal of all sectoral taxes (Consideration 3A(i)) leads to a **net decrease in government revenues of around EUR -41 billion**. This reflects revenue decreases across all three sectors, with the largest decline occurring in insurance. In this scenario, the additional VAT generated by applying VAT to financial services is more than offset by the removal of sectoral taxes and by the reduction in hidden VAT.

By contrast, when VAT at standard rates is introduced while sectoral taxes are maintained (Consideration 3A(i)b), government revenues **increase substantially, by around EUR +30 billion**. In this case, additional VAT revenues are generated without any corresponding loss of sector-specific taxes. Under the revenue-neutral variant (Consideration 3A(ii)), total revenues remain broadly unchanged by design: small increases are observed from the insurance sector (EUR +9 billion), which are fully compensated by decreases in banking (EUR -1 billion) and other financial services (EUR -8 billion).

Table 73. Total impact on government tax revenues of removing the VAT exemption and removing or maintaining sectoral taxes, in EUR billion (partial equilibrium)

Impact on government revenues of removing the VAT exemption and removing or maintaining sectoral taxes	Impact (B2B + B2C) - EUR bn			
	Banking	Insurance	Other financial services	Total
3A(i)a – VAT on all services, standard rates, removal of all sectoral taxes	-2	-29	-11	-41

3A(i)b – VAT on all services, standard rates, sectoral taxes maintained	15	20	-6	30
3A(ii) – VAT on all services, revenue-neutral rates, sectoral taxes maintained	-1	9	-8	<1
3B(i)a – VAT on fee-based services, standard rates, proportional removal of sectoral taxes	-8	-29	-11	-47
3B(i)b – VAT on fee-based services, standard rates, sectoral taxes maintained	4	20	-6	19
3B(ii) – VAT on fee-based services, revenue-neutral rates, sectoral taxes maintained	-1	10	-8	1

The results for **Consideration 3B**, where VAT is applied only to fee-based services, follow a similar pattern but with some differences in the magnitude of impacts. Under Consideration 3B(i)a, revenues decrease by around EUR –47 billion, reflecting the way VAT revenues are modelled in this scenario. When VAT is applied only to fee-based services, the effective VAT rate is reduced in proportion to the share of fee-based activities, and sectoral tax revenues decline proportionally with the reduction in the taxable base. As a result, the **increase in VAT revenues is smaller than the corresponding reduction in sectoral tax revenues**, leading to lower overall revenues.

By contrast, under the standard-rate scenario with sectoral taxes maintained (Consideration 3B(i)b), revenues increase by around EUR +19 billion. Under the **revenue-neutral variant (Consideration 3B(ii))**, total revenues remain broadly unchanged.

A more detailed understanding emerges when distinguishing between B2B and B2C segments. For the **B2B segment**, all considerations lead to **reductions in government revenues**, ranging from approximately EUR –8 billion to EUR –41 billion (Considerations 3A(i)a and 3A(i)b respectively). The largest decreases are observed under the scenarios combining VAT reform with the removal of all sectoral taxes, Considerations 3A(i)a and 3B(i)a, where B2B revenues decrease by around EUR -41 billion and EUR -40 billion, respectively. These reductions reflect the removal of sectoral taxes, the reduction in hidden VAT, and lower net VAT collection from business transactions, since business customers are **generally able to deduct input VAT**.

When sectoral taxes are maintained, the B2B revenue losses are smaller but remain negative. Under the standard-rate variants, B2B revenues decline by around EUR -8 billion under Consideration 3A(i)b and EUR -11 billion under Consideration 3B(i)b. Under the revenue-neutral variants, B2B revenues decrease by around EUR -15 billion under Consideration 3A(ii) and EUR -12 billion under Consideration 3B(ii). Overall, the B2B results reflect the fact that VAT deductibility limits the revenue-raising potential of applying VAT to business-to-business financial services, while **changes in hidden VAT** and sector-specific taxation continue to affect government revenues.

Table 74. B2B impact on government tax revenues of removing the VAT exemption and removing or maintaining sectoral taxes, in EUR billion (partial equilibrium)

Impact on revenues of removing the VAT exemption and removing or maintaining sectoral taxes	Impact on B2B segment - EUR bn			
	Banking	Insurance	Other financial services	Total
3A(i)a – VAT on all services, standard rates, removal of all sectoral taxes	-12	-17	-12	-41
3A(i)b – VAT on all services, standard rates, sectoral taxes maintained	<1	-1	-7	-8
3A(ii) – VAT on all services, revenue-neutral rates, sectoral taxes maintained	-5	-2	-8	-15
3B(i)a – VAT on fee-based services, standard rate, proportional removal of sectoral taxes	-12	-17	-12	-40
3B(i)b – VAT on fee-based services, standard rates, sectoral taxes maintained	-3	-1	-7	-11

3B(ii) – VAT on fee-based services, revenue-neutral rates, sectoral taxes maintained	-2	-2	-8	-12

Differences between **Considerations 3A and 3B** are primarily explained by the **scope of the tax base**. Because Consideration 3B applies VAT only to fee-based services rather than to all financial services, the revenue effects differ mainly in the banking sector. Under **Consideration 3B(ii)**, the decline in B2B revenues (EUR –12 billion) is slightly smaller than under Consideration 3A(ii) (EUR –15 billion), reflecting the narrower VAT base in banking.

Table 75. B2C impact on government tax revenues of removing the VAT exemption and removing or maintaining sectoral taxes, in EUR billion (partial equilibrium)

Impact on revenues of removing the VAT exemption and removing or maintaining sectoral taxes	Impact on B2C segment - EUR bn			
	Banking	Insurance	Other financial services	Total
3A(i)a – VAT on all services, standard rates, removal of all sectoral taxes	10	-12	1	0
3A(i)b – VAT on all services, standard rates, sectoral taxes maintained	15	21	2	37
3A(ii) – VAT on all services, revenue-neutral rates, sectoral taxes maintained	4	11	-1	14
3B(i)a – VAT on fee-based services, standard rate, proportional removal of sectoral taxes	4	-12	1	-7
3B(i)b – VAT on fee-based services, standard rates, sectoral taxes maintained	7	21	2	29
3B(ii) – VAT on fee-based services, revenue-neutral rates, sectoral taxes maintained	1	12	0	13

Turning to the B2C segment, Consideration 3A exhibits outcomes that vary substantially depending on whether sectoral taxes are maintained or removed. Under the standard-rate scenario combined with the removal of all sectoral taxes (Consideration 3A(i)a), the **B2C impact on revenues is broadly revenue-neutral overall**.

By contrast, when sectoral taxes are maintained (Consideration 3A(i)b), the B2C segment generates a substantial increase in revenues of around EUR +37 billion, driven by higher VAT revenues from banking and insurance. Under the **revenue-neutral variant (Consideration 3A(ii))**, the B2C segment continues to generate positive revenues overall (approximately EUR +14 billion), although to a lesser extent than under the standard-rate scenario.

For Consideration 3B, the **B2C impacts are systematically less favourable** than under Consideration 3A, reflecting the narrower scope of the tax base. Under the **standard-rate scenario combined with the removal of all sectoral taxes (Consideration 3B(i)a)**, the B2C segment records a **small net decrease in revenues of around EUR –7 billion.** By contrast, when sectoral taxes are maintained (Consideration 3B(i)b), revenues increase substantially (around EUR +29 billion). Under the **revenue-neutral variant (Consideration 3B(ii))**, the B2C segment continues to generate positive revenues overall (around EUR +13 billion).

➢ *Insight from the sensitivity analysis*

To assess the robustness of the findings to alternative parameter values, this section **compares the total estimated impacts across four scenarios**. The core scenario, S1, assumes a pass-through rate of 0.8 and a household demand elasticity of -0.5. The sensitivity scenarios test lower pass-through with the same elasticity (S2: pass-through 0.6; elasticity -0.5), lower demand responsiveness with moderate pass-through (S3: pass-through 0.7; elasticity -0.2), and higher demand responsiveness with moderate pass-through (S4: pass-through 0.7; elasticity -1.0).

For sales of financial services, the results are sensitive to the assumed demand elasticity and pass-through rate, but **the overall ranking of policy considerations remains stable across scenarios**. Scenarios combining VAT reform with the removal of all sectoral taxes consistently generate positive effects on total sales, while scenarios in which sectoral taxes are maintained generate negative effects, except for the revenue-neutral variants, which remain close to zero. The largest positive effects are observed under S4, where demand is assumed to be more responsive to price: total sales increase by around EUR +22 billion under Consideration 3A(i)a and EUR +27 billion under Consideration 3B(i)a. The most negative effects are also observed under S4 when standard-rate VAT is introduced while sectoral taxes are maintained, with total sales decreasing by around EUR -19 billion under Consideration 3A(i)b and EUR -12 billion under Consideration 3B(i)b.

The lower-elasticity scenario, S3, produces more muted sales effects, as expected. Under this scenario, total sales increase by around EUR +4 billion under Consideration 3A(i)a and EUR +5 billion under Consideration 3B(i)a, while losses are limited to around EUR -4 billion under Consideration 3A(i)b and EUR -2 billion under Consideration 3B(i)b. The lower pass-through scenario, S2, also dampens the estimated effects compared with the core scenario, but to a lesser extent than the low-elasticity scenario. Overall, the sensitivity analysis confirms that **the magnitude of sales impacts is driven primarily by the extent to which tax changes are passed through to prices and by the responsiveness of demand to those price changes**, while the direction of effects remains broadly unchanged across scenarios.

Table 76. Impact on sales: comparison of total impact across sensitivity scenarios

Impact on sales of removing the VAT exemption and/or sectoral taxes	Impact (B2B + B2C) - Total in EUR bn			
	Core (S1)	S2	S3	S4
3A(i)a – VAT on all services, standard rates, removal of all sectoral taxes	13	10	4	22
3A(i)b – VAT on all services, standard rates, sectoral taxes maintained	-11	-8	-4	-19
3A(ii) – VAT on all services, revenue-neutral rates, sectoral taxes maintained	<1	<1	<1	<1
3B(i)a – VAT on fee-based services, standard rates, removal of all sectoral taxes	15	11	5	27
3B(i)b – VAT on fee-based services, standard rates, sectoral taxes maintained	-7	-5	-2	-12
3B(ii) – VAT on fee-based services, revenue-neutral rates, sectoral taxes maintained	<1	<1	<1	-1

For government revenues, the **results vary much less across scenarios than the sales impacts**. This reflects the fact that government revenue effects are driven primarily by the tax design itself, in particular whether sectoral taxes are removed or maintained, rather than by changes in demand. Across all scenarios, the removal of all sectoral taxes leads to sizeable revenue losses: around EUR -41 billion under Consideration 3A(i)a and around EUR -46 billion to EUR -48 billion under Consideration 3B(i)a. These estimates are almost unchanged across S1 to S4.

By contrast, when sectoral taxes are maintained and VAT is applied at standard rates, government revenues increase in all scenarios. Under Consideration 3A(i)b, the increase ranges from around EUR +26 billion to EUR +33 billion, while under Consideration 3B(i)b it ranges from around EUR +16 billion to EUR +21 billion. Revenue-neutral variants remain close to zero by design, with total impacts between EUR -1 billion and EUR +2 billion. Overall, the sensitivity analysis indicates that the **estimated revenue impacts are robust to alternative pass-through and elasticity assumptions**, with only limited variation across scenarios.

Table 77. Impact on government revenues: comparison of total impact across sensitivity scenarios

	Impact (B2B + B2C) - Total in EUR bn

Impact on revenues of removing the VAT exemption and/or sectoral taxes	Core (S1)	S2	S3	S4
3A(i)a – VAT on all services, standard rates, removal of all sectoral taxes	-41	-41	-41	-41
3A(i)b – VAT on all services, standard rates, sectoral taxes maintained	30	31	33	26
3A(ii) – VAT on all services, revenue-neutral rates, sectoral taxes maintained	0	0	0	-1
3B(i)a – VAT on fee-based services, standard rates, removal of all sectoral taxes	-47	-47	-48	-46
3B(i)b – VAT on fee-based services, standard rates, sectoral taxes maintained	19	20	21	16
3B(ii) – VAT on fee-based services, revenue-neutral rates, sectoral taxes maintained	1	2	2	1

➢ *Macroeconomic impacts on sales and revenues: insights from the NEMESIS model*

In addition to the partial-equilibrium model (PEM), the NEMESIS macroeconomic model also estimates impacts on sales and government revenues associated with the different considerations. Although the two models capture different transmission channels and different orders of economic effects, it is important to assess whether they lead to broadly consistent conclusions regarding the relative effects of the different considerations. Overall, the **results from the two models appear broadly aligned** in terms of the direction and relative ranking of impacts across considerations.

Box 24. Why PEM and NEMESIS results should be interpreted as complementary rather than directly comparable

The PEM estimates direct, static impacts in the 2023 reference year, using Eurostat-based financial product sales measured in value terms. NEMESIS, by contrast, is a dynamic macroeconomic model calibrated on FIGARO data, in which the policy measures under review are introduced in 2026 and impacts are assessed after wider economy-wide adjustments have taken place, mainly by 2030.

In addition to this key difference, sales are not measured in exactly the same way: the PEM captures changes in value terms, reflecting both prices and quantities, while NEMESIS primarily captures changes in demand volumes through standard demand equations.

For this reason, the results should not be expected to correspond on a one-to-one basis. Instead, the two models should be viewed as complementary: the PEM provides the direct and immediate effects on financial product sales and tax revenues, while NEMESIS captures broader macroeconomic adjustments over time.

For sales, both models show that the removal of sectoral taxes combined with VAT reform tends to generate more favourable effects than scenarios in which sectoral taxes are maintained as shown in Table 78. Under Consideration 3A(i)a, **both models estimate positive impacts on sales**, although the macroeconomic estimate is very slightly smaller than the partial-equilibrium estimate. Under Consideration 3B(i)a, the macroeconomic model also estimates a positive effect on sales, but this effect is slightly more muted than in the PEM. By contrast, where standard-rate VAT is introduced while sectoral taxes are maintained, both models estimate negative sales effects, with NEMESIS showing more pronounced declines, particularly under Consideration 3B(i)b. The revenue-neutral variants generate very limited effects in the PEM, while NEMESIS estimates small negative effects on sales, reflecting broader economy-wide adjustments.

For government revenues, the two models produce **closely aligned results overall**. Both models estimate sizeable revenue losses when sectoral taxes are removed, especially under Considerations 3A(i)a and 3B(i)a, and positive revenue effects when standard-rate VAT is introduced while sectoral taxes are maintained. The magnitude of revenue impacts is generally similar across the two models, with differences reflecting the fact that NEMESIS captures indirect macroeconomic feedback effects through changes in production, consumption and employment. As in the partial-equilibrium model, the revenue-neutral variants remain close to neutral overall.

The differences between the models are consistent with their respective scopes. The PEM captures direct impacts on prices, sales and revenues within the financial sector itself, while NEMESIS captures wider **macroeconomic adjustment mechanisms across the whole economy**. As a result, NEMESIS generally shows more negative sales effects in scenarios where sectoral taxes are maintained, reflecting indirect effects from higher effective taxation on household demand, firms' input costs and wider economic activity. Conversely, in scenarios where sectoral taxes are removed, NEMESIS can show smaller sales gains than the PEM because the direct positive price effects are partly offset by macroeconomic feedback effects elsewhere in the economy. Overall, the comparison suggests that, despite methodological differences, the two modelling approaches lead to broadly similar conclusions regarding the relative economic effects of the different considerations.

Table 78. Comparison of impacts on sales and revenues from the partial equilibrium and macroeconomic models

Impact of removing the VAT exemption and sectoral taxes	Impact (B2B + B2C) - EUR bn			
	On sales		On revenues	
	Partial equilibrium (PEM)	Macro-economic (NEMESIS)	Partial equilibrium (PEM)	Macro-economic (NEMESIS)
3A(i)a – VAT on all services, standard rates, removal of all sectoral taxes	13	11	-41	-35
3A(i)b – VAT on all services, standard rates, sectoral taxes maintained	-11	-16	30	31
3A(ii) – VAT on all services, revenue-neutral rates, sectoral taxes maintained	<1	-4	<1	2
3B(i)a – VAT on fee-based services, standard rates, proportional removal of sectoral taxes	15	5	-47	-43
3B(i)b – VAT on fee-based services, standard rates, sectoral taxes maintained	-7	-20	19	23
3B(ii) – VAT on fee-based services, revenue-neutral rates, sectoral taxes maintained	<1	-10	1	2

14.2.2 Macroeconomic impacts

This section presents macroeconomic impacts based on the NEMESIS model (see description in introduction to Part C above), for year 2030. This relates to the period of five years after the introduction of the policy change, at which time maximum impacts will have been reached. As explained, in addition to 'non-recycling' scenarios whereby any changes in tax revenues would be retained by governments, the model also provides estimated impacts for scenarios whereby additional VAT revenues (or losses) are 'recycled' into the economy through VAT, either through changes in VAT rates on other goods and services or through lump-sum transfers to (or from) households.

The results are presented in terms of impacts on **GDP and its main components** (final consumption, investment, and the trade balance), as well as **employment**. The trade balance reflects the difference between exports and imports, such that a positive change indicates an improvement in the economy's net trade position. Employment impacts are reported separately for total employment and for high-skilled and low-skilled workers.

Although the impacts on sales of financial services remain relatively limited in the partial-equilibrium model, the **macroeconomic model captures broader economy-wide transmission mechanisms**. In particular, even relatively small changes in the effective cost of financial services may propagate through household consumption, firms' intermediate input costs, investment and labour demand across the wider economy. Under some considerations, macroeconomic effects are also influenced by substantial changes in government revenues under the no-recycling scenario.

➢ *GDP components*

The simulations from the macroeconomic model suggest that the **effects on GDP components are noticeable but remain moderate overall** (see Table 79). Under the no-recycling scenarios, the application of VAT at standard rates to all financial services combined with the removal of all sectoral taxes (Consideration 3A(i)a) is associated with a reduction in EU GDP of about EUR –16 billion by 2030, corresponding to –0.1% below baseline. This is driven mainly by a fall in final consumption of EUR –39 billion (–0.2%) and a decline in investment of EUR –11 billion (–0.1%), while the trade balance improves by EUR +35 billion (0.2 percentage points of GDP). **Final consumption is therefore the most affected GDP component**, indicating that the contractionary effect is borne primarily through household demand. The improvement in the trade balance partly offsets this decline, which explains why the **overall GDP impact remains small**.

When sectoral taxes are maintained under standard VAT rates (Consideration 3A(i)b), the negative macroeconomic effects become somewhat larger. GDP falls by EUR –29 billion (–0.2%), final consumption by EUR –52 billion (–0.3%), and investment by EUR –15 billion (–0.1%), while the trade balance improves by EUR +45 billion. The revenue-neutral scenario with sectoral taxes maintained (Consideration 3A(ii)) produces somewhat smaller negative impacts, with GDP declining by EUR –14 billion (–0.1%), final consumption by EUR –28 billion (–0.2%), and investment by EUR –8 billion (–0.2%), while the trade balance improves by EUR +24 billion.

The fee-based considerations under 3B follow the **same overall pattern, but with smaller absolute effects**. Without recycling, 3B(i)a leads to a very small positive GDP impact of EUR +3 billion, close to zero in percentage terms, despite a fall in final consumption of EUR +18 billion (-0.1%), while investment remains broadly unchanged and the trade balance improves by EUR +19 billion. While this differs from the small GDP decline observed under 3A(i)a, the underlying component-level effects are broadly similar. In both cases, lower final consumption is partly offset by an improvement in the trade balance, although under 3B(i)a the trade balance gain is slightly larger than the consumption loss, resulting in a marginally positive GDP effect. When sectoral taxes are maintained under standard VAT rates (Consideration 3B(i)b), GDP declines by EUR –10 billion (-0.1%), final consumption by EUR –31 billion (-0.2%), and investment by EUR –3 billion while the trade balance improves by EUR +29 billion. Under the revenue-neutral scenario (Consideration 3B(ii)), GDP falls by EUR –5 billion, final consumption by EUR –17 billion, and investment by EUR –2 billion, while the trade balance improves by EUR +16 billion.

When the additional revenues are recycled through a reduction in VAT rates on other goods and services, the **negative GDP effects are substantially attenuated** and, in several cases, turn positive. Under Consideration 3A(i)a, GDP increases by around EUR +10 billion, although final consumption remains EUR –9 billion below baseline and investment EUR –3 billion below baseline. These effects are partly offset by a EUR +19 billion improvement in the trade balance. By contrast, when sectoral taxes are maintained under standard VAT rates (Consideration 3A(i)b), GDP is almost unchanged, with final consumption EUR –21 billion below baseline and investment EUR –6 billion below baseline. Under the revenue-neutral scenario (Consideration 3A(ii)), GDP increases slightly by EUR 2 billion, while final consumption and investment remain modestly below baseline.

For the fee-based considerations, recycling through lower VAT rates leads to **broadly neutral or slightly positive aggregate results**. Under Consideration 3B(i)a, GDP increases by EUR +3 billion (<0.1%), while final consumption still falls by EUR –18 billion (-0.1%) and investment is largely unchanged. Under Consideration 3B(i)b, GDP increases by around EUR +8 billion, with final consumption EUR -11 billion below baseline and investment EUR +2 billion above baseline. Under Consideration 3B(ii), GDP increases by around EUR +6 billion, while final consumption falls by EUR -6 billion and investment increases by EUR +2 billion. Overall, **recycling through lower VAT rates appears to neutralise most of the 'negative' impacts** seen in the no-recycling scenario.

When **revenues are recycled through lump-sum transfers to/from households, macroeconomic outcomes become more favourable overall**, particularly for GDP and final consumption. Under Consideration 3A(i)a, GDP increases by EUR +19 billion (0.1%) and final consumption by EUR +9 billion

(0.1%), although investment remains EUR –10 billion below baseline. Under Considerations 3A(i)b and 3A(ii), GDP also becomes positive overall, increasing by EUR +6 billion and EUR +7 billion respectively, while final consumption remains close to baseline levels.

For the fee-based considerations, recycling through lump-sum transfers produces the strongest positive GDP effects under Consideration 3B(i)a, where GDP increases by EUR +24 billion (0.1%) and final consumption by EUR +11 billion (0.1%), while investment remains marginally above baseline. Under Considerations 3B(i)b and 3B(ii), GDP increases by EUR +11 billion and EUR +8 billion respectively, supported primarily by positive trade balances. Overall, **recycling through lump-sum transfers has a positive effect on GDP for all considerations**, particularly through stronger support to household demand leading to largely neutral effect on final consumption and a more favourable trade balance.

Table 79. Total impact of the taxation of financial services on GDP and its components under different revenue recycling scenarios (macroeconomic model) – in EUR billion, 2030 deviation from baseline

Impact on GDP components 2030 deviation from baseline		EUR bn (% change between baseline and 2030)			
Consideration	**Recycling**	**GDP**	**Final consumption**	**Investment**	**Trade balance***
3A(i)a – VAT on all services, standard rates, removal of all sectoral taxes	No recycling	-16 (-0.1%)	-39 (-0.2%)	-11 (-0.1%)	35 (0.2%)
3A(i)b – VAT on all services, standard rates, sectoral taxes maintained		-29 (-0.2%)	-52 (-0.3%)	-15 (-0.1%)	45 (0.3%)
3A(ii) – VAT on all services, revenue-neutral rates, sectoral taxes maintained		-14 (-0.1%)	-28 (-0.2%)	-8 (<0.1%)	24 (0.1%)
3B(i)a – VAT on fee-based services, standard rates, proportional removal of sectoral taxes		3 (<0.1%)	-18 (-0.1%)	<1 (<0.1%)	19 (0.1%)
3B(i)b – VAT on fee-based services, standard rates, sectoral taxes maintained		-10 (-0.1%)	-31 (-0.2%)	-3 (<0.1%)	29 (0.2%)
3B(ii) – VAT on fee-based services, revenue-neutral rates, sectoral taxes maintained		-5 (<0.1%)	-17 (-0.1%)	-2 (<0.1%)	16 (0.1%)
3A(i)a – VAT on all services, standard rates, removal of all sectoral taxes	Recycling through reduced VAT rates	10 (0.1%)	-9 (-0.1%)	-3 (<0.1%)	19 (0.1%)
3A(i)b – VAT on all services, standard rates, sectoral taxes maintained		-1 (<0.1%)	-21 (-0.1%)	-6 (<0.1%)	29 (0.2%)
3A(ii) – VAT on all services, revenue-neutral rates, sectoral taxes maintained		2 (<0.1%)	-9 (-0.1%)	-2 (<0.1%)	15 (0.1%)
3B(i)a – VAT on fee-based services, standard rates, proportional removal of sectoral taxes		3 (<0.1%)	-18 (-0.1%)	<1 (<0.1%)	19 (0.1%)
3B(i)b – VAT on fee-based services, standard rates, sectoral taxes maintained		8 (<0.1%)	-11 (-0.1%)	2 (<0.1%)	19 (0.1%)
3B(ii) – VAT on fee-based services, revenue-neutral rates, sectoral taxes maintained		6 (<0.1%)	-6 (<0.1%)	2 (<0.1%)	10 (0.1%)
3A(i)a – VAT on all services, standard rates, removal of all sectoral taxes	Recycling through lump-sum transfers to/from households	19 (0.1%)	9 (0.1%)	-10 (-0.1%)	15 (0.1%)
3A(i)b – VAT on all services, standard rates, sectoral taxes maintained		6 (<0.1%)	-3 (<0.1%)	-14 (-0.1%)	25 (0.1%)
3A(ii) – VAT on all services, revenue-neutral rates, sectoral taxes maintained		7 (<0.1%)	1 (<0.1%)	-7 (<0.1%)	12 (0.1%)
3B(i)a – VAT on fee-based services, standard rates, proportional removal of sectoral taxes		24 (0.1%)	11 (0.1%)	1 (<0.1%)	7 (<0.1%)
3B(i)b – VAT on fee-based services, standard rates, sectoral taxes maintained		11 (0.1%)	-1 (<0.1%)	-2 (<0.1%)	17 (0.1%)
3B(ii) – VAT on fee-based services, revenue-neutral rates, sectoral taxes maintained		8 (<0.1%)	<1 (<0.1%)	-1 (<0.1%)	9 (0.1%)

** Trade balance surplus in GDP points difference from the status quo scenario. Detailed impacts of policy considerations on exports and imports are shown in Annex 5*

➢ *Employment*

The employment results are **broadly consistent with the overall patterns on GDP components**, as shown in Table 80, in the sense that the overall dynamic between considerations and variants remains the same. In particular, the most negative employment effects, like the most negative GDP effects, are observed when sectoral taxes are maintained under standard VAT rates. Under the no-recycling scenarios, employment effects vary considerably across considerations. Consideration 3A(i)a is associated with a reduction in whole-economy employment of around 64 thousand jobs by 2030. The negative effects become substantially larger when sectoral taxes are maintained under standard VAT rates (Consideration 3A(i)b), with employment declining by around 474 thousand jobs (–0.2%). Under the revenue-neutral scenario with sectoral taxes maintained (Consideration 3A(ii)), the decline is smaller, at around 182 thousand jobs (–0.1%).

For the fee-based considerations under 3B, **the pattern is more mixed**. Under Consideration 3B(i)a, employment increases by around 77 thousand jobs (<0.1%), reflecting a small positive effect on both high-skilled and low-skilled employment. By contrast, when sectoral taxes are maintained under Consideration 3B(i)b, total employment declines by around 330 thousand jobs (-0.2%). Under the revenue-neutral scenario 3B(ii), employment falls by around 158 thousand jobs (-0.1%).

The **employment effects are generally distributed evenly between high-skilled and low-skilled workers, although the balance varies by scenario**. Under the no-recycling scenarios, the largest employment losses are observed under Consideration 3A(i)b, where high-skilled employment declines by around 178 thousand jobs and low-skilled employment by around 295 thousand jobs. In absolute terms, low-skilled employment losses tend to be larger than high-skilled employment losses in the scenarios with negative aggregate employment effects. However, under Consideration 3B(i)a, both high-skilled and low-skilled employment increase, by around 41 thousand and 36 thousand jobs respectively.

Recycling through lower VAT rates leads to smaller employment losses, and in some cases positive effects. Under Consideration 3A(i)a, the aggregate employment effect turns positive, with an increase of around 121 thousand jobs. Under Consideration 3A(i)b, the decline in employment is reduced from around 474 thousand jobs under no recycling to around 278 thousand jobs, while under Consideration 3A(ii), the loss is reduced to around 68 thousand jobs. For the fee-based considerations, employment remains positive under Consideration 3B(i)a, with an increase of around 77 thousand jobs, while the employment losses under Considerations 3B(i)b and 3B(ii) are smaller than under the no-recycling scenarios, at around 206 thousand and 84 thousand jobs respectively. The magnitudes of employment losses are similar across high-skilled and low-skilled workers, making this scenario **more neutral** than the no-recycling scenario from a distributional perspective.

When revenues are recycled through lump-sum transfers to/from households, employment outcomes become **more favourable overall**. Under Consideration 3A(i)a, total employment increases by around 206 thousand jobs, with positive effects on both high-skilled and low-skilled employment. Under Considerations 3A(i)b and 3A(ii), employment decreases to around 201 thousand and 21 thousand jobs respectively, due to the retention of sectoral taxes, which raise production costs and dampens labour demand.

For the fee-based considerations, recycling through lump-sum transfers produces the most favourable employment outcomes. Under Consideration 3B(i)a, employment increases by around 240 thousand jobs overall. Under Considerations 3B(i)b, employment effects remain negative but the decline is reduced by roughly half compared with the no-recycling scenario (163 thousand jobs). Under Consideration 3B(ii), employment falls by around 61 thousand jobs. Overall, **recycling through lump-sum transfers offsets most of the contractionary employment effects observed under the no-recycling scenarios, and, in the variants involving the removal of sectoral taxes, generates positive employment effects,** in line with the more favourable GDP impacts observed under this recycling mechanism. Across the considerations, low-skilled employment effects are generally comparable to high-skilled employment effects in absolute terms.

Table 80. Total impact of the taxation of financial services on employment under different revenue recycling scenarios (macroeconomic model) – in thousands of employees

Impact on employment 2030 deviation from baseline		Thousand persons (% change between baseline and 2030)		
Consideration	**Recycling**	**Total employment**	**High-skilled employment**	**Low-skilled employment**
3A(i)a – VAT on all services, standard rates, removal of all sectoral taxes	No recycling	-64 (<0.1%)	4 (<0.1%)	-68 (-0.1%)
3A(i)b – VAT on all services, standard rates, sectoral taxes maintained		-474 (-0.2%)	-178 (-0.2%)	-295 (-0.2%)
3A(ii) – VAT on all services, revenue-neutral rates, sectoral taxes maintained		-182 (-0.1%)	-63 (-0.1%)	-119 (-0.1%)
3B(i)a – VAT on fee-based services, standard rates, proportional removal of sectoral taxes		77 (<0.1%)	41 (0.1%)	36 (<0.1%)
3B(i)b – VAT on fee-based services, standard rates, sectoral taxes maintained		-330 (-0.2%)	-140 (-0.2%)	-190 (-0.1%)
3B(ii) – VAT on fee-based services, revenue-neutral rates, sectoral taxes maintained		-158 (-0.1%)	-66 (-0.1%)	-92 (-0.1%)
3A(i)a – VAT on all services, standard rates, removal of all sectoral taxes	Recycling through reduced VAT rates	121 (0.1%)	64 (0.1%)	58 (<0.1%)
3A(i)b – VAT on all services, standard rates, sectoral taxes maintained		-278 (-0.1%)	-115 (-0.1%)	-163 (-0.1%)
3A(ii) – VAT on all services, revenue-neutral rates, sectoral taxes maintained		-68 (<0.1%)	-25 (<0.1%)	-42 (<0.1%)
3B(i)a – VAT on fee-based services, standard rates, proportional removal of sectoral taxes		77 (<0.1%)	41 (0.1%)	36 (<0.1%)
3B(i)b – VAT on fee-based services, standard rates, sectoral taxes maintained		-206 (-0.1%)	-99 (-0.1%)	-106 (-0.1%)
3B(ii) – VAT on fee-based services, revenue-neutral rates, sectoral taxes maintained		-84 (<0.1%)	-41 (-0.1%)	-42 (<0.1%)
3A(i)a – VAT on all services, standard rates, removal of all sectoral taxes	Recycling through lump-sum transfers to/from households	206 (0.1%)	92 (0.1%)	114 (0.1%)
3A(i)b – VAT on all services, standard rates, sectoral taxes maintained		-201 (-0.1%)	-89 (-0.1%)	-112 (-0.1%)
3A(ii) – VAT on all services, revenue-neutral rates, sectoral taxes maintained		-21 (<0.1%)	-9 (<0.1%)	-12 (<0.1%)
3B(i)a – VAT on fee-based services, standard rates, proportional removal of sectoral taxes		240 (0.1%)	95 (0.1%)	146 (0.1%)
3B(i)b – VAT on fee-based services, standard rates, sectoral taxes maintained		-163 (-0.1%)	-85 (-0.1%)	-78 (-0.1%)
3B(ii) – VAT on fee-based services, revenue-neutral rates, sectoral taxes maintained		-61 (<0.1%)	-34 (<0.1%)	-28 (<0.1%)

At sectoral level, employment effects are **visible across all three financial sub-sectors**, with the strongest negative impacts generally observed under the considerations where sectoral taxes are maintained alongside the application of standard VAT rates (3A(i)b and 3B(i)b) which is aligned with the effects on total employment shown just above. Under these considerations, employment declines across the three sectors. By contrast, the corresponding considerations involving the removal of all sectoral taxes (3A(i)a and 3B(i)a) generate more favourable employment outcomes, although effects differ across sub-sectors. Insurance and other financial services tend to benefit more, while banking remains weaker, especially when VAT is applied to all financial services. The revenue-neutral variants with sectoral taxes maintained generally produce intermediate or mixed effects, while the lower-rate variants are associated with positive employment effects across all three sub-sectors. Overall, the **sectoral employment results are consistent with the broader macroeconomic patterns** observed for GDP and aggregate employment. More details on sectoral employment effects are shown in Annex 5.

➢ *Insight from the sensitivity analysis*

To assess the robustness of the macroeconomic findings to alternative parameter values, this section **compares the estimated impacts on GDP and total employment across four scenarios**. As already mentioned, the core scenario, S1, assumes a pass-through rate of 0.8 and a household demand elasticity of -0.5. The sensitivity scenarios test lower pass-through with the same elasticity (S2), lower demand responsiveness with moderate pass-through (S3), and higher demand responsiveness with moderate pass-through (S4). They were estimated under the assumption of no recycling.

Overall, the sensitivity analysis suggests that the **ranking and qualitative interpretation of the policy considerations remain broadly stable across scenarios**. For GDP, impacts remain **moderate in all cases,** as shown in Table 81 below. The largest negative effects are consistently observed under standard-rate VAT scenarios where sectoral taxes are maintained, especially Consideration 3A(i)b, where GDP declines by between around EUR -23 billion and EUR -33 billion depending on the scenario. The revenue-neutral variants produce smaller negative effects, while Consideration 3B(i)a, where VAT is applied only to fee-based services and sectoral taxes are removed proportionally, remains close to neutral or slightly negative across scenarios.

The employment impacts show **greater variation across scenarios than GDP impacts**, but the overall pattern remains similar. The largest employment losses are again observed when sectoral taxes are maintained alongside standard VAT rates, particularly under Consideration 3A(i)b and 3B(i)b. Under Consideration 3A(i)b, total employment declines by between around 371 thousand and 552 thousand jobs across scenarios, while under Consideration 3B(i)b the decline ranges from around 220 thousand to 428 thousand jobs. By contrast, Consideration 3B(i)a remains associated with positive employment effects across all scenarios, although the magnitude varies.

The sensitivity analysis therefore confirms that the **macroeconomic effects are not driven by a single set of parameter assumptions**. Changes in pass-through and demand elasticity affect the magnitude of the results, particularly for employment, but do not materially alter the main conclusions: macroeconomic impacts remain moderate overall, and the least favourable outcomes are generally observed when standard-rate VAT is introduced while sectoral taxes are maintained.

Table 81. Macroeconomic impacts: comparison of total impact on GDP and employment across sensitivity scenarios

Impact of removing the VAT exemption and/or sectoral taxes	Impact on GDP - EUR bn				Impact on total employment - Thousand persons			
	Core (S1)	S2	S3	S4	Core (S1)	S2	S3	S4
3A(i)a – VAT on all services, standard rates, removal of all sectoral taxes	-16	-19	-21	-13	-64	-118	-141	-39
3A(i)b – VAT on all services, standard rates, sectoral taxes maintained	-29	-29	-33	-23	-474	-423	-371	-552
3A(ii) – VAT on all services, revenue-neutral rates, sectoral taxes maintained	-14	-15	-17	-12	-182	-175	-162	-204
3B(i)a – VAT on fee-based services, standard rates, removal of all sectoral taxes	3	-2	-2	4	77	17	10	80
3B(i)b – VAT on fee-based services, standard rates, sectoral taxes maintained	-10	-12	-14	-6	-330	-287	-220	-428
3B(ii) – VAT on fee-based services, revenue-neutral rates, sectoral taxes maintained	-5	-6	-7	-3	-158	-140	-106	-205

An additional sensitivity analysis examined the **implications of assuming that Switzerland and the UK implement equivalent policy changes to the EU**. The results, presented in Annex 5, indicate that this assumption has only a very limited effect on the estimated macroeconomic impacts. Across all considerations, GDP impacts are slightly less favourable than in the core scenario, with differences of

around EUR -2 billion to EUR -4 billion. Employment impacts also become somewhat less favourable in most scenarios, although the changes remain moderate relative to the overall employment effects. The largest differences are observed under the revenue-neutral and standard-rate variants with sectoral taxes maintained, while the relative ordering of considerations remains unchanged. Overall, the results suggest that the **main findings are not materially affected by assumptions regarding the policy responses of Switzerland and the UK.**

14.2.3 Impacts on legal certainty

➢ *Continuation of the status quo*

The problem analysis (see Chapter 9) highlighted the complex and shifting framework needed to apply the VAT exemption to the financial sector, which inevitably leads to **substantial legal uncertainty and complexity that is exacerbated by discrepancies between Member States**. Aspects identified as particular contributors to legal uncertainty include the rules for proportional VAT deduction, discrepancies in the implementation and application of other structural provisions (the option to tax, VAT groups and cost-sharing arrangements – CSAs), and problems with and discrepancies in the definitions of certain services used to determine the scope of the VAT exemption[650]. Sectoral taxes contribute to this dynamic due to their large number, multifarious interactions with the VAT framework and diversity across the EU; in this respect, the targeted consultation identified navigating different IPT frameworks as an area of complexity for insurance companies operating in multiple Member States.

Since these issues are **intrinsically linked to the existence of the VAT exemption** (and, to an extent, IPTs), they would be expected to persist under the continuation of the status quo. Indeed, they are likely to become more pronounced over time. This is in part because further progress towards EU policies like the Savings and Investment Union (SIU) will promote trade in the Single Market in financial services, increasing the prevalence of the cross-border operations which are especially complex and difficult to deal with. Relatedly, as other forms of regulatory complexity to trade in the Single Market gradually decline, the relative prominence of the tax framework as a barrier will increase. In addition, evolving technology will continue to foster intermediation and longer value chains, increasing the share of operations whose VAT treatment is either difficult to determine or disadvantageous compared to functionally similar activities (e.g., exempt payment services provided from within a bank vs taxed intermediate services supplied by a niche company), leading to complex arrangements to achieve the desired tax treatment (in addition to causing market distortions, as discussed in Section 14.2.5 below).

➢ *Removal of the exemption for all financial services (Policy Consideration 3A)*

Removing the VAT exemption for financial services entirely would **eliminate in one fell swoop all existing problems intrinsically related to the exemption**, for both providers of financial services and tax authorities enforcing the rules. The problematic boundaries between 'taxed' and 'exempt' services, and the grey areas in between, would mostly fade away (though not completely in the neutral-VAT rate variant – 3A(ii), as discussed below). Furthermore, by restoring the full right to deduct input VAT, it would also remove any legal uncertainty with respect to other structural provisions, since the purpose these has been to account for and reduce the amount of "hidden' VAT and they would no longer be needed for that end. Similarly, since this policy consideration would also remove IPTs and other sectoral taxes, any uncertainty regarding their application, particularly for providers of financial services with cross-border operations would also disappear.

The drawback of this policy consideration from the perspective of legal certainty is not that it would fail to address the existing problems, but that it would create new ones. These hark back to the original rationale for the exemption, which is the **technical difficulty of applying VAT to certain financial services outputs**. For fee-based services this would be relatively straightforward, since these can readily serve as a taxable

[650] While most service definitions were found to be clear and consistently applied, several were identified as sources of uncertainty, namely insurance-related services; the management of investment funds and related asset-management services, supporting payment services, derivatives and custody services.

basis for VAT[651]. As highlighted in the problem analysis (Section 9.2.1), many countries with VAT/GST systems outside the EU's immediate orbit apply VAT to certain or all fee-based financial services, including Australia, India, Japan, Mexico, New Zealand, Singapore and South Africa. While the exact modalities vary, none of the research on these countries revealed notable problems of application or legal certainty with the VAT systems in place. As such, the **benefits in terms of increased legal certainty for the insurance and asset management industries**, which are remunerated entirely in fees and commissions, **would be significant and unambiguous**.

That said, **two measures to smooth the implementation of this policy consideration** would be needed, as described in Section 11.4. Firstly, the place of supply rules for B2C services, which ordinarily would be the country where the supplier is based, would need to be changed to the destination country. This would eliminate the risk of operators supplying services from Member States with a relatively low VAT rate. By applying this change to the whole sector and allowing, for cross-border services, suppliers to remit VAT to the appropriate tax authority using the One-Stop Shop or mandatory reverse charge, the risk of any uncertainty would be minimised. Secondly, for financial derivatives, the approach proposed leaves most derivatives trading outside the scope of VAT until a trade is executed, at which time a taxable transaction occurs. It still leaves one class of derivatives within the scope of VAT: options (i.e. commitments to do something). In this case, a formula to calculate the taxable basis should be identified, drawing from national approaches which have already been developed, either to apply the option to tax or to calculate the value of supplies for *pro rata* calculations. Any fees charged for the negotiation, issuance, closure or other management activities of any derivatives would remain taxable.

This approach is in line with those of jurisdictions applying VAT to financial services[652], and has not been reported as problematic.

Applying VAT to interest-based services carries greater practical challenges. This is due to the central problem of how to determine the tax base in a way that both adheres to the principles of the VAT system and avoids unworkable conceptual and practical difficulties. A key issue is that **banks could not be asked to apply VAT to two of the main sources of financing used to make loans to customers**, namely deposits and central bank financing (see Box 24). Indeed, it is telling that no jurisdiction taxes these components, and that, while theoretical approaches to doing some have been developed and discussed hypothetically, they have not been tested in the real world due to their complex and impractical nature[653]. This is a major downside of this policy consideration that cannot readily be solved.

[651] Though certain trading activities, such as high-frequency trading activities, could potentially pose practical problems for the collection of VAT due to the high volume of transactions, these are typically remunerated on a global margin basis, either at the end of a period such as a day or when a margin is paid to a customer. Maintaining such conventions in the application of VAT would significantly reduce the scope for potential issues, since these core transactions represent only a small total of the number of trades.

[652] Cf., for instance, the German guidelines on the VAT treatment of various financial services: *Umsatzsteuerliche Beurteilung der Leistungen im Wertpapier- und Depotgeschäft*, BMF v. 03.02.2015 - IV D 3 - S 7160/14/10002.

[653] Cf. Section 11.4, particularly the discussion on the cash-flow method. While this brings both incoming and outgoing flows of money into the VAT chain and thus allows interest-based services to be incorporated into the transaction VAT system, it achieves this by taxing the principal on loans, creating significant upfront costs and potential liquidity problems. As such, it has long been considered impractical and never implemented in practice. Cf. Zee, H. H. (2005). A New Approach to Taxing Financial Intermediation Services Under a Value–Added Tax. National Tax Journal, *58*(1), 77-92. A variant of this method, called the 'truncated' cash-flow method, has been developed to address the liquidity issue, but instead would require complex tracking and offsets of consumer accounts, and equally it has not been tested in practice.

Box 25. The challenges of applying VAT to deposits and central bank financing

Banks have many sources of funding, but two of the major ones could not be subject to VAT: (i) deposits: in theory, one could impose VAT on passive interest rates, i.e., those paid by banks to depositors, as if the depositors 'charged' VAT; however, when the depositor is a private individual, this would not be compatible with the key VAT principle that only persons carrying out an economic activity are taxable; and (ii) financing provided by central banks, which would be excluded from taxation because monetary policy is an activity carried out in their capacity of public authorities (Article 13 of the VAT Directive).

When it comes to applying VAT to financial services outputs, **three approaches are considered with a view to approximating the effects of VAT as closely as possible without sacrificing practicability**. These define the tax base as either (i) gross interest charged to customers, (ii) interest margin minus average loss provision, and (iii) net revenues. Each of these addresses the implementation challenges and thus could be applied without causing significant new uncertainty or difficulties, at least once banks, their customers and tax authorities adjust to the new regime. However, because these approaches each depart from the principles of the fractionated VAT system in important ways, they would not fully address the issues of the current situation, as a closer look at them shows.

The first approach is to **define the tax base as the gross interest charged to customers**. This approach is applied in China for all interest-based services (see Section 3.2.4), as well as (at relatively limited scale) under Germany's option to tax regime (see Section 7.1.1). The main advantage of this approach is its simplicity. The gross interest rate is known, readily communicated and unambiguous, allowing this segment to be brought into the VAT system without excessive complexity or opportunities for manipulation / arbitrage on the tax base. Since this can also be cited on VAT invoices to business customers, they are able to recover the VAT incurred and thus improving VAT neutrality for this market segment. Unfortunately, the gross interest incorporates costs above and beyond the core service of credit provision, such as funding costs and risks of default, for which the bank is unable to define and deduct input VAT. This overstates the VAT base and inflates VAT liabilities for B2C purchasers of consumer loans and other customers without the right of deduction[654], to an extent that would in all likelihood render the approach unfeasible. This could be addressed through rates differentiated by service and customer type, but only by introducing a level of complexity akin to the current VAT exemption, and the associated risks of divergent interpretation, arbitrage, and burdensome compliance and enforcement processes.

The **second approach defines the tax base for a transaction as the interest margin minus loss provision**. In contrast with gross interest, this approach comes closer to reflecting real value added and thus avoids overstating the tax base. However, the complexity of application and knock-on effects of this entail considerable drawbacks (see description of the practicalities in Section 11.4.1). These mirror the problems seen in other margin-based VAT schemes, such as the tour operators' margin scheme (TOMS) and the margin scheme for second-hand goods[655]. Namely, the margin can be difficult and resource-intensive to calculate, report on and verify for both tax authorities and businesses, undermining the rationale for a policy change aimed at reducing complexity and simplifying compliance. As importantly, since the margin for each transaction may not be known at the time in which the transaction is invoiced and is commercially sensitive, it cannot be communicated to customers and conveyed on a VAT invoice, engendering persistent hidden VAT for business customer who would otherwise enjoy the right to deduct. As explained in Section 11.4.1, while there are ways of getting around this, it is not possible to do so on a transaction basis linking a specific input – a deposit – to a specific output – a loan; instead, added value is determined based on variables that are calculated at aggregate level for past rather than current transactions. This has implications for market functioning, as discussed below (Section 14.2.5). In theory,

[654] Li, N., & Krever, R. (2017). Loan intermediary services: China. In R. F. van Brederode, & R. Krever (Eds.), VAT and Financial Services: Comparative Law and Economic Perspectives (pp. 109-122)., cf. (PDF) Loan Intermediary Services: China.

[655] The legal provisions of both schemes are laid out in the VAT Directive, TOMS in Articles 306 to 310 and second-hand goods in Articles 311 to 313.

like with the gross-interest approach, this problem could be addressed in part through differentiated VAT rates, but again at cost of additional complexity that may exceed that of the existing exemption framework.

The **third approach eschews transaction-based VAT, and taxes net interest revenues instead**. This would closely mirror the approach recently introduced in Brazil (see Section 3.2) and bring the benefit of simplicity, since financial institutions already keep track of interest revenue as part of normal reporting requirements. In a sense, this captures the advantages of both other approaches: as with the gross margin, calculating the tax base is relatively simple, while, as with the transactional margin approach, the tax base more closely adheres to added value. However, it is also incompatible with VAT invoices, generating hidden VAT and the resulting distortions, including for the significant proportion of financial services outputs that serve as intermediate consumption for other providers of financial services, as discussed below under market functioning. To a certain extent, this could be addressed by periodic statements from providers of financial service to their customers itemising the amount of VAT paid, calculated on a pro-rata basis of payments made, though this would add to complexity and administrative / enforcement costs. Moreover, taxing revenue instead of transactions denudes VAT of one of its core features, calling into the question the rationale for such an approach. Indeed, it more similar as a mechanism to the FAT discussed as policy consideration 3C below than to VAT as such.

Taking together the three approaches to taxing interest-based services, it is thus **clear that they could be implemented in practice without insurmountable technical or practical barriers**. At the same time, making each of them workable requires important compromises that go to the heart of what defines VAT, as a fractionated, broad-based consumption tax. Given that they would each add new areas of potential uncertainty and complexity in addition to resolving existing ones, it is unclear whether the net impact of this policy consideration on legal certainty would be net positive or negative. This is regardless of the approach applied to interest-based services, since none of these stands out as clearly superior to the others. It also explains the very limited enthusiasm for taxing interest-based services that emerged from the targeted consultation. Aside from a general skittishness towards major policy changes, none of the tax authorities or banks expressing an opinion considered that a policy change including the application of VAT to interest-based services would make the tax framework simpler and more certain than the current situation.

Finally, it is important to note that **this policy consideration also includes variants with different VAT rates** (standard VAT or revenue-neutral rates), **as well as carve-outs** that would retain the VAT exemption for payment accounts with basic features and pension funds. By removing the VAT exemption and sectoral taxes, variant 3A(i)a provides for a simpler tax framework than the variants leaving sectoral taxes in place. Although the sectoral taxes were not found to cause significant legal uncertainty, removing them would reduce the scope for ambiguity even further (e.g., for providers of cross-border services). By contrast, the application of revenue-neutral VAT rates in variant 3A(ii) and the carve outs for essential services would add incrementally to the complexity of implementation. For example, the services retaining the exemption would need to be defined, leading to questions of interpretation that could be reduced (e.g., by adhering to accepted regulatory definitions for certain services) but not entirely eliminated. For variant 3A(ii), the financial stakes of applying less than standard-rate VAT could be high in certain countries, increasing the importance of robust compliance and enforcement mechanisms. While unlikely to pose more than minor barriers to implementation, this would eat away at the simplification potential of the policy change.

- ***Removal of the exemption for fee-based services only (Policy Consideration 3B)***

This policy consideration would **address many of the existing problems for legal certainty, while avoiding the pitfalls** of attempting to apply VAT to interest-based services.

For **insurance and asset management services, the impacts on legal certainty would be as described above**, since, as mentioned these services are priced in fees, commissions or similar considerations. Namely, businesses and tax authorities would no longer face uncertainty about whether certain services were taxed or exempt (though, as with 3A, the problem would persist to a degree for the variant applying reduced VAT rates), and the restoration of full deduction rights would eliminate the complexity and uncertainty associated with the proportional deduction rules and other structural provisions. IPTs would also be removed, along with the uncertainty engendered by their fragmentation across borders. The place

of supply changes and special rules for derivatives included in consideration 3A would still be needed, but these are not considered causes of uncertainty. Crucially, the relatively straightforward nature of defining the tax base for financial and other asset management services means that, beyond any initial teething problems, no new uncertainty is expected.

in contrast, **the impacts on legal certainty for the banking sector would be more nuanced**. This is because a majority (ca 73% on average) of banking turnover is interest-based and would thus remain exempt from VAT. Important benefits to legal certainty would still materialise from the reduced need to ascertain whether certain fee-based services are exempt or taxed and increased uniformity of treatment between different types of service providers (e.g., full-service banks vs niche payment services providers). But banks would still be providers of mixed outputs, and therefore be subject to the deduction rules and need to rely on the other structural provisions to minimise their hidden VAT.

In addition, any **increased legal certainty for the banking sector would be, to a certain extent, offset by the regulatory need to minimise the risks** the grey areas that will inevitably arise (e.g., for loans remunerated based on a combination of fees and interest margins), as well as the potential for price arbitrage among service providers seeking to optimise tax treatment. As explained in Section 11.4, this would addressed by specific measures to define the tax treatment for services prone to these issues. While necessarily adding an element of complexity, the successful application of VAT to fee-based services in multiple jurisdictions suggests that occurrences of arbitrage would be manageable and not cause excessive uncertainty or complexity for banks or tax authorities[656].

This consideration would also include variants with differentiated VAT rates and carve-outs for essential services, as with consideration 3A. The impacts would be the same, namely incremental increases in regulatory complexity and a minor erosion of the increased certainty sought with this policy change.

14.2.4 Impacts on regulatory costs

The problem analysis (see Section 9.3.2) and the section dedicated to compliance costs (Section 7.2) discuss at length that the current VAT framework for financial services gives rise to a number of administrative costs for businesses in the sector, primarily linked to the need to apply complex rules for determining deductible input VAT and managing mixed taxable and exempt activities. In practice, compliance requires financial institutions to allocate inputs between taxed, exempt and mixed-use transactions, calculate pro-rata deduction rates, and adapt internal accounting systems and reporting processes accordingly. According to the results of the targeted consultation, these tasks typically require more effort than compliance under the standard VAT treatment, as well as often the involvement of external advisors.

Under the **status quo**, the study found that VAT compliance requires between around 0.1 and 2 full-time equivalent staff in institutions with an annual turnover below EUR 2 billion and between approximately 0.45 and 15 full-time equivalents in entities with a turnover higher than that. Moreover, stakeholders reported that additional external advisory costs are generally incurred. When monetised, the costs per the normally efficient company were estimated at close to EUR 80,000 per year for smaller entities and EUR 240,000 for larger entities.[657] Extrapolated to the EU level, these administrative costs amount to approximately **EUR 1.3 billion annually** for the financial sector as a whole. Without new policy intervention, the **administrative costs are likely to remain at a similar level**.

In addition to VAT-related obligations, financial institutions must comply with a range of **national sectoral taxes**, such as insurance premium taxes and other levies applied in some Member States. While the number of taxes and administrative costs differs per country, a company in the financial sector has to comply with roughly 3 sectoral taxes on average. Compliance with these taxes also generates administrative costs for businesses, which are estimated to amount to roughly EUR 35,000 – 215,000 per company, depending on

[656] These include seven of the third countries examined (see Section 3.2), as well as in those Member States with the option to tax.

[657] Median results, see Section 7.2 on compliance costs for further details.

the size and type of entity.[658] At the EU level, this amounts to close to **EUR 900 million per year**. Similar to the administrative costs stemming from the VAT exemption, these **costs are likely to at least persist** in the baseline scenario. Considering the developments in recent years, where several countries have introduced new sectoral taxes, it is **likely that compliance burdens will increase slightly** in the upcoming years.

For the purposes of assessing the expected administrative costs under the two considerations 3A and 3B, the focus is on the recurring administrative costs incurred by businesses in complying with VAT obligations and sectoral taxes. The estimates used therefore capture ongoing administrative costs, primarily reflecting staff time devoted to tax compliance activities and related external expenditures. Due to the limited availability of data, the analysis does not quantify one-off costs associated with potential policy changes, such as the adaptation of IT systems, procedural changes within firms, or the need for tax authorities to develop and implement new administrative arrangements. Such transition costs could arise if, as would be the case for these policy considerations, the VAT treatment of financial services were to be fundamentally reformed, but they are inherently difficult to estimate ex ante.

More generally, the quantification of administrative cost changes in this area is subject to a degree of uncertainty. The application of VAT to financial services on a broad scale has never been implemented in the EU, and practical approaches for determining the tax base remain largely theoretical in some cases. As a result, there is limited empirical evidence on how regulatory complexity and compliance costs would evolve under such a system. While the estimates presented below provide an indication of the potential order of magnitude of recurring administrative costs, they rely on assumptions regarding the likely evolution of compliance processes and should therefore be interpreted with caution. They are complemented by a qualitative assessment of administrative cost implications under each policy consideration.

- ***Policy consideration 3A***

Under **policy consideration 3A**, the VAT exemption for financial services would be removed and replaced by standard VAT treatment. Depending on the variant, VAT would be applied either at a standard rate (variant 3A(i) or at a revenue-neutral rate (variant 3(A)(ii), but this is not considered to have any impact on regulatory costs. In addition, under variant 3A(i)a, all sectoral taxes would be abolished, while under variant 3A(i)b and 3A(ii), sectoral taxes would be maintained. Compared to the baseline described above, this would modify the structure of tax compliance for financial institutions. On the one hand, certain administrative costs linked to the VAT exemption would disappear. On the other hand, applying VAT to all financial services would introduce additional compliance obligations related to invoicing requirements.

In terms of administrative savings, the composition of cost reductions varies depending on the variant applied. Under variant 3A(i)b and 3A(ii), where sectoral taxes are maintained, the reductions would arise from the disappearance of **compliance activities linked to the VAT exemption**. Under variant 3A(i)a, however, the removal of all sectoral taxes would generate savings of a comparable or greater magnitude, due to the complete elimination of administrative burdens related to such taxes.

Regarding VAT-related savings, the need to apply the rules for proportional deduction would be the most significant factor. As discussed in the section on compliance costs, these rules represent one of the most resource-intensive elements of VAT compliance for financial institutions. In addition, stakeholder feedback suggests that dealing with the VAT exemption generally entails somewhat higher administrative costs than applying standard VAT treatment. Based on the targeted consultation, the analysis assumes that moving to standard VAT treatment would reduce the remaining VAT administrative costs by roughly 5% to 15%, once proportional deduction rules are removed. Applying these assumptions to the estimated **VAT administrative costs** of the sector results in annual **savings of approximately EUR 190 million to EUR 570 million** (of which, roughly EUR 135 – 150 million is saved due to the elimination of the proportional deduction calculations).

[658] Asset managers are estimated to have comparatively low administrative burdens from sectoral taxes, while large banks have relatively higher costs to face, as described in more detail in Section 7.2.

Further savings may arise from the removal of **sectoral taxes** under variant 3A(i)a, where all identified sectoral taxes would be abolished. As outlined already, these taxes generate administrative costs for financial institutions that vary across Member States. Banks and insurance companies are generally more exposed to sectoral taxes than asset managers – the former through bank levies and similar charges, the latter through IPTs – and would therefore tend to benefit more from their removal. Across the sector as a whole, estimated savings are highest for banks, followed by insurers and asset managers, though these figures reflect population-level estimates rather than the situation of any individual institution. Applying this assumption to the estimated baseline administrative costs for sectoral taxes results **in estimated annual savings of up to EUR 870 million** at EU level – this represents the full elimination of administrative burdens from sectoral taxes. Under sub-options 3A(i)b and 3A(ii), where sectoral taxes are maintained, these savings would not materialise.

At the same time, applying VAT to all financial services would also introduce **additional compliance obligations** for businesses. In particular, financial institutions would need to comply with standard VAT information requirements, including invoicing and reporting obligations that currently do not apply to many exempt financial services. These additional obligations would generate **new administrative costs, estimated at roughly EUR 140 million per year**.

Taking these elements together, the overall impact of policy consideration 3A is estimated to result in **net administrative cost savings of roughly EUR 50 million to EUR 1.3 billion annually** for businesses in the financial sector. The breadth of this range is primarily driven by the treatment of sectoral taxes. Under sub-option 3A(i)a, where all sectoral taxes are removed, savings are substantially higher than under sub-options 3A(i)b and 3A(ii), where they are maintained and only VAT-related savings materialise. When taking sectoral taxes out of the equation, savings would range from EUR 50 to EUR 430 million annually.

For single providers of financial services, the savings are expected to vary considerably, reflecting differences in size, business model, and exposure to sectoral taxes. Banks and insurers would generally stand to benefit more than asset managers, given their greater exposure to bank levies and IPTs respectively. A typical bank or insurance company is estimated to save between EUR 50 000 for a smaller entity and up to over EUR 300 000 for a larger entity under the upper bound scenario with full removal of sectoral taxes. Without removal of sectoral taxes, the savings would be more modest at around EUR 10 000 for a smaller entity and up to slightly over EUR 100 000 for a larger bank or insurer. While these estimates remain subject to uncertainty, particularly given the lack of practical experience with a fully taxable VAT framework for financial services, they indicate that the removal of the exemption would likely lead to a moderate reduction in overall administrative costs for businesses.

The administrative cost estimates presented above are not expected to differ significantly across the different VAT rate variants considered under policy consideration 3A (standard rates or revenue neutral rates). This is because the main drivers of administrative costs relate to the *structure* of the VAT exemption rather than to the level of the applicable VAT rate[659]. Consequently, the estimates presented above apply equally to all rate variants. The same considerations apply below for the estimates under policy consideration 3B.

- ***Policy consideration 3B***

Under **policy consideration 3B**, the VAT exemption would be removed only for fee-based financial services, while interest-based services would remain exempt. As described above, it is assumed that services provided by insurance companies and asset managers would become fully taxable, whereas for banks, an analysis of the data provided by EBA shows that the turnover associated with approximately 27% of services at EU level would be subject to VAT, while the remaining 73% corresponds to interest-based services that continue to be exempt. As a result, **any administrative cost savings would materialise fully for insurance companies and asset managers**, **while in the banking sector the baseline existing costs would largely persist**.

[659] The complexity arising from using reduced rates are discussed in Section 14.2.1above.

The sources of administrative cost changes under this consideration are broadly similar to those described for policy consideration 3A. Where services become taxable, the removal of the VAT exemption would eliminate the need to apply rules for proportional deduction and would reduce some of the administrative costs associated with managing exempt supplies. Applying the same methodological approach as under consideration 3A, these changes would result in estimated savings of about **EUR 130 million to EUR 400 million per year from reduced VAT administrative costs**.

Additional savings may arise from the **removal of sectoral taxes** under variant 3B(i)a. The logic here broadly mirrors that under 3A, with one important distinction for the banking sector: since VAT would only apply to fee-based services under 3B, any removal of sectoral taxes for banks would be limited to the proportion attributable to those services. Given the difficulty of isolating this share with any precision, no savings are assumed for banks under this consideration. For insurers and asset managers, by contrast, sectoral taxes would be fully removed, generating savings on the same order as under consideration 3A. This results in estimated **annual savings of up to EUR 520 million at EU level** under sub-option 3B(i)a. Under sub-options 3B(i)b and 3B(ii), where sectoral taxes are maintained, these savings would not materialise.

The same considerations – that similar cost savings would occur, just at a lower scale – apply also for additional administrative costs stemming from reporting and invoicing requirements. Since only part of the financial services would become taxable under this consideration, the **associated additional costs would be lower** than under consideration 3A and are **estimated at EUR 20-30 million per year**.

Overall, policy consideration 3B is therefore estimated to result in **net administrative cost savings of around EUR 105 million to EUR 885 million per annum**. For insurers and asset managers, the savings per company are estimated to remain in line with those under 3A. More in detail, the annual savings in administrative costs are estimated to be roughly between EUR 50 000 (lower bound for an insurance company with less than EUR 2 billion annual turnover) and over EUR 300 000 (upper bound for an insurance company with more than EUR 2 billion annual turnover) for a typical insurance. For a typical asset management entity, the range is estimated at approximately EUR 40 000 to EUR 220 000.

However, compared with consideration 3A, the continued application of the VAT exemption to a large share of banking services would mean that certain administrative costs, most notably those to comply with the proportional deduction rules, would continue to apply. Consequently, **it is not expected that the policy change would trigger substantial administrative savings for banks**. Moreover, the coexistence of exempt and taxable treatments within the same institutions may create additional operational complexity. In particular, banks may need to maintain parallel processes and systems to manage different VAT treatments for interest-based and fee-based services, potentially requiring adaptations to accounting systems, internal procedures and additional staff training. While such adjustments are likely to entail one-off implementation costs and could introduce some additional complexity, these effects are not quantified in the present analysis. Table 82 below summarises the administrative cost savings under policy considerations 3A and 3B.

Table 82. Administrative cost savings under policy consideration 3A & 3B (*NB: savings expressed in positive figures compared the baseline, and additional costs in negative figures)*

		VAT compliance savings (EUR million)	Sectoral tax compliance savings (EUR million)	Additional admin costs (EUR million)	Total administrative cost savings
3A	Banks	60 – 180	0 – 350	-110	-50 – 420
	Insurances	50 – 140	0 – 270	-10	40 – 400
	Asset Managers	90 – 260	0 – 250	-10	80 – 500
	EU Total	**190 – 570**	**0 – 870**	**-140**	**50 – 1,300**
3B	Banks	-	-	-	-

	Insurances	50 – 140	0 – 270	-10	40 – 400
	Asset Managers	90 – 260	0 – 250	-10	80 – 500
	EU Total	**130 – 390**	**0 – 520**	**-25**	**105 – 885**

Note: Sectoral tax compliance savings range from 0 (3A(i)b, 3A(ii), 3B(i)b and 3B(ii), where sectoral taxes are maintained) to the upper bound (3A(i)a, where all sectoral taxes are removed). Total figures do not all appear to add up due to rounding.

➢ *Tax authorities*

From the perspective of **tax authorities**, the **current VAT exemption for financial services does not appear to represent a significant administrative or enforcement costs**. As discussed in Section 7.2, most Member States indicated that administering and enforcing the exemption requires similar or even fewer resources than other areas of VAT compliance. While certain aspects of the regime, particularly the rules for proportional deduction, can create complexity in individual audits, tax authorities generally reported that enforcement costs remain limited and that disputes or fraud in the sector are relatively rare.

Under policy considerations 3A and 3B, some elements of this administrative framework would change. In particular, the removal of the exemption for certain or all financial services would **eliminate the need for tax administrations to verify proportional deduction calculations**. At the same time, the extension of VAT to a larger volume of financial transactions would **introduce additional administrative tasks** linked to standard VAT obligations, such as invoicing, record-keeping and reporting requirements. Tax authorities may therefore need to devote additional resources to monitoring compliance with VAT obligations for financial service providers, particularly in relation to the determination of the taxable base for complex financial transactions. This would be reinforced by the fact that increased VAT liabilities for financial services providers would also raise the stakes, making the verification of compliance more important.

The available evidence does not allow a precise quantification of the net impact of these changes on administrative costs for tax authorities. Given that enforcement costs associated with the exemption are currently considered limited, the **removal of the exemption would likely lead to some increase in administrative effort** due to the higher number and value of taxable transactions subject to VAT control. However, **these additional costs would likely remain modest** in comparison with other areas of VAT administration and the broader regulatory framework governing financial institutions.

14.2.5 Market impacts

➢ *Continuation of the status quo*

The VAT exemption disrupts market functioning in two main ways. Firstly, **it breaks VAT neutrality** by taxing intermediate rather than end consumption, resulting in hidden VAT that increases the cost of input purchases and distorts market behaviours and business models. This was identified as one of the most serious problems with the current situation which, as explained in Section 9.2, discourages investment in specialisation and the innovative practices and business models[660] that have progressively been enabled by technological change. Such an environment slows the development and adoption of new practices, which in turn harms the competitiveness of EU firms and the economy. Start-ups and SMEs, which have less regulatory capacity and depend on more established financial institutions as customers, are disproportionately impacted.

[660] These include traditional back-office functions (e.g., IT, accounting or tax services) that can increasingly be provided more efficiently by specialist providers and / or groupsourced (i.e., the increasingly common practice whereby a single entity within a corporate group provides specialised inputs) as well as more innovative fintech services active in several clusters including payment and digital banking, embedded finance, insurtech, investment-related services (e.g., roboadvisers), regtech, and banking as a service.

groupsourcing, which is the increasingly common practice whereby a single entity within a corporate group provides specialised inputs, such as IT services or back-office accounting or tax functions, as well as outsourcing models.

The existing structural provisions – notably VAT groups, CSAs and the option to tax – serve to alleviate the distortion, but only to a partial extent, while the lack of VAT neutrality and its distorting effects have been by far the most heavily criticised feature of the current regime. This is evident from the targeted consultation, in which all of the ca 140 companies taking part highlighted the artificially increased cost of outsourcing, as well as position papers from stakeholder groups[661]. While comprehensive quantitative analysis of this distortion was not possible, the qualitative findings from the targeted consultation and other stakeholder input consistently showed that the financial burden of outsourcing discouraged the practice, even when otherwise considered more efficient. This was in line with the empirical analysis that could be conducted on a specific case regarding the differing treatment of outsourced asset management services[662].

Given continued trends in digitalisation, which favours specialisation and niche providers, it appears near certain that the significance of the market distortions – currently rated as 'moderate' in the problem analysis will become more pronounced over time, stifling innovation and business performance.

Secondly, **the VAT treatment of financial services, including how the exemption is applied and the optional structural provisions, as well as the different sectoral taxes, poses barriers to trade in the Single Market**. This is at odds with EU policies such as the CMU, SIU, passporting and others aimed at fostering integration, and makes it more difficult for EU firms to grow and thrive. At present the magnitude of this barrier is minor: while the cross-border trade of financial services is limited except in certain market segments (i.e., fund and asset management), this is attributed to national regulatory frameworks rather than to tax fragmentation. However, removing other regulatory barriers is an increasing political priority, which makes progress on this front likely in the coming years. As such, without further action, tax fragmentation could move from periphery to the centre as a hindrance to cross-border trade and related efforts by providers of financial services to scale up and compete globally.

- ***Removal of the exemption for all financial services (Policy Consideration 3A)***

This policy consideration is rooted in the intention to improve market functioning, and as expected, the impacts in this area are mostly positive. Removing the exemption would restore VAT neutrality, eliminating concerns about hidden VAT for providers of financial services. While the dynamics are too complex to measure and predict quantitatively, this would **restore the level playing field** between outsourcing / groupsourcing and internally produced inputs. Instead of facing a price barrier equal to the VAT rate, specialised B2B suppliers would be able to compete on a level playing field with customers seeking to organise their value chains as efficiently as possible. Barriers to collaboration between service providers would fade away, improving the conditions for innovation as well as the position of external providers of financial supplies and the firms that rely on them.

Large conglomerates would be well-placed to take advantage of undistorted markets for outsourced services. They would be able to organise themselves more efficiently and reduce costs (e.g. by groupsourcing across borders in large corporate groups, which is not possible under the current regime due to the domestic character of VAT groups). Benefits would be even more significant for start-ups and other SMEs, since many of these either provide and / or rely on outsourcing to a larger degree and would thus improve their competitive position and channel investment towards innovative services and digitalisation; relevant fields include fintechs and payment service providers, as well as more established models in insurance intermediation, cooperative banking, mutual insurance and asset management).

[661] For example, in its most recent position paper on the tax framework for financial services, the European Banking Federation devoted the first line of the section on VAT to the need for neutrality, and went on to note deleterious effects of hidden AT such as a loss of competitiveness for EU financial institutions, and the discouraging of outsourcing. Cf. European Banking Federation, *Modernising the tax framework for financial institutions and financial services*, 2025.

[662] Specifically, the analysis considered the propensity of insurance companies to outsource asset management services, with a comparison between countries where this supply would and would not be exempt. While the results were not statistically significant and thus need to be interpreted cautiously, they showed that insurance companies incurring hidden VAT on purchases of asset management services were less likely to outsource these. See discussion in Section 7.1.4.

Although not likely to be immediately felt due to the presence of other regulatory barriers, **removing the exemption and IPTs would also make it easier to trade on the Single Market** by eliminating problems related to discrepancies and divergence between Member States. This would reduce the need for providers to familiarise themselves with the local peculiarities of the VAT exemption framework (e.g., precise service definitions, deduction rules etc.), thereby (as discussed above) reducing uncertainty and simplifying compliance. Especially in a future scenario where initiatives related to the CMU and SIU facilitate the sale and purchase of financial services across borders within the EU, removing the VAT exemption could clear the path for such trade to take place unhindered. Importantly, the change in the place of supply rules accompanying this policy consideration (which for B2C supplies would make this the country of the customer) would minimise any incentives to supply financial services from Member States with relatively low VAT rates. By a similar logic, risks to the EU State Aid framework[663] also seem very limited. Specifically, while issues with state end tend to arise when a Member State provides favourable tax treatment selectively to national champions, under this policy consideration, all providers to customers in a given Member State would face equal VAT treatment.

When it comes to **international competitiveness**, the macroeconomic model (Section 14.2.2) shows – after tax revenue changes have been recycled – very limited impacts on both investment and the trade balance with third countries[664]. This suggests that impacts on competitiveness would be minor, which is in line with the limited nature of the problems caused by the current tax framework in this regard. Still, better market functioning from the elimination of hidden and improved efficiency could improve profitability and the business climate, increasing EU firms' ability to invest. In a similar vein, this would also make it easier for service providers – including SMEs – applying new technologies and business models to gain a foothold and attain the scale necessary to compete globally. The amended place of supply rules would also reduce the scope for tax competition from providers of financial services to EU customers based outside the EU (as is common in certain market segments, such as fund management), as well as avoiding the creation of tax advantages for digital vs brick-and-mortar service providers.

For business customers of financial services with the right to deduct, **removing the exemption would also reduce their costs to a certain extent, shoring up their competitive position** vis-à-vis businesses in third countries continuing to exempt financial services. Indirectly, reducing the prices for these customers of services like insurance would also reduce the costs of risk, potentially encouraging more for ambitious behaviour. Conversely, increasing these costs for private consumers and other customers without the right of deduction (like government actors) would have the opposite effect. Since the precise net impacts on B2B and B2C segments would vary by country and sector, it is difficult to speculate on the net impacts.

Against these largely positive impacts, any decision to remove the exemption for interest-based services would need to consider the **serious and distorting impacts on the cost of consumer credit and monetary policy**. The first of these relates to the nature of VAT and other ad valorem taxes, which are typically designed for prices denoted in currency, rather than percentages. In the case of the latter, applying VAT could create amplifying, and thereby distortive, effects. Specifically, the risk is that, when interest rates are low, VAT would have only marginal impacts on the cost of credit, but that, in a higher interest-rate environment, even modest rate adjustments would trigger significant swings in prices. That said, this issue would differ in prominence – and indeed my not occur at all – depending on the approach to defining the tax base, as explained in the box below.

Box 26. The interference of VAT on transmission mechanisms for monetary policy

Applying VAT to interest-based financial services could have distorting effects on the transmission of monetary policy, but these would differ in magnitude from negligible to serious depending on the approach to defining the VAT tax base, and surrounding contextual factors.

[663] The EU State Aid framework is defined in Article 107 TFEU, which prohibits state aid unless exceptionally justified.

[664] The macroeconomic modelling exercise included scenarios whereby Switzerland and the UK did and did not make corresponding policy changes, with only extremely limited measurable impacts foreseen.

Among the three approaches assessed, the distortion would be felt most acutely when defining the tax base as the gross interest rate. Defining the tax base as the interest margin, the amplifying dynamic would be similar, but much less pronounced, or even zero, since only the spread – rather than the gross interest charged – would be taxed. This is not always the case, and variation in the interest rate set by the ECB may result in different competitive conditions, and hence different margins. For instance, the very low rates in the 2010s were associated with compressed interest margins, while the rate increases in 2022-23 were accompanied by an expansion of banks' interest margins. If taxing net revenues instead, then VAT would not be applied on a transaction basis and thus not create distorting effects on monetary policy beyond those by existing taxes on bank turnover and profits, such as CIT and bank levies.

Compounding this problem would be the variation in VAT rates across Eurozone countries, since this would essentially mean that changes in monetary policy would be transmitted differently into national credit markets and rates for consumers due not to factors related to banking or the economy, but due to the otherwise unrelated statutory VAT rate in each country[665] or, if the net interest margin is chosen as the taxable basis, on the local competitive conditions in the banking market.

Additionally, the spread between discount and market rates would increase, and **different lenders would face different market rates** as a consequence of VAT. The increase in the spread between the discount rate set by the ECB and market rate could be addressed by setting a different (lower) discount rate, which takes into account the fiscal (VAT) treatment of loans. However, the effect would be different depending on the categories of customers, as VAT is neutral for B2B customers with full right of deduction, while it is an additional burden for B2B customers without a full right of deduction, as well as for individual consumers (B2C) and public entities (B2G). The magnitude of the discrepancy would depend on interest-rate levels, being negligible at times of low and ultra-low rates and growing as rates increase.

Importantly, the **impact on open market operation**s should also be taken into account, and minimised. Monetary policy is carried out inter alia by the central banks buying and selling securities, providing loans and accepting deposits, as well as via repo operations; those operations are carried out between central banks and authorised (primary) financial institutions. When 'providing' the above services or selling securities to financial intermediaries, central banks are not subject to VAT as they are considered as not carrying on a business activity based on Article 13 of the VAT Directive, which excludes public authorities, engaging in transactions as public authorities, from the scope of VAT. However, should the exemption be removed, some of these transactions could become subject to VAT when a central bank is on the receiving end. This would alter the symmetry of open market operations, whose value for the central bank would vary depending on who the supplier of the operation is from the VAT perspective, and in which Member State the operation takes place (as it would be subject to national VAT rates). This impact could be mitigated by carving out an exception and keeping the supply of financial services to central banks except from VAT, or providing for a VAT refund mechanism to the central banks.

Finally, any adverse consequences for monetary policy are likely to be more contained if only fee-based services are brought within the scope of VAT, rather than removing the exemption for all financial services. In particular, the impact on credit markets would be significantly smaller, particularly if mitigating measures are introduced to prevent arbitrage between fees and higher interest-based pricing.

This policy consideration also includes **variants that would remove or retain sectoral taxes and apply different – either standard or revenue-neutral – VAT rates**. Variant 3A(i)a, which would combine standard VAT rates and the removal of sectoral taxes, offers more potential for simplification and the reduction of tax fragmentation in the EU. Differentiated sectoral taxes were found to play only a limited role in hampering trade in the Single Market and the competitiveness of EU providers of financial services. Nonetheless, in principle 3A(i)a would still be expected to improve market functioning more than 3A(i)b and 3A(ii), by reducing the need to grapple with distinct and complex tax rules between countries, and the incentives for jurisdiction shopping (which was found to be tax driven in some cases). On the negative side, variant 3(ii), by introducing lower VAT rates for financial services, could potentially distort markets by artificially reducing the prices of financial services compared to the rest of the economy. However, given that the rates are designed to be revenue neutral (meaning that the application of VAT on outputs is accompanied by the right to deduct input VAT), the effects would be expected to be minor.

Finally, maintaining the exemption for essential services means that, for the associated sectoral output and input costs (see discussion of their scale in Section 14.2.6 on social impacts), the current problems would remain in place. In other words, providers would still incur a certain amount of hidden VAT, structural provisions would be needed to address this and determine proportional deductions, the interpretations would potentially differ across countries.

- ***Removal of the exemption for fee-based services only (Policy Consideration 3B)***

For the **insurance and asset management sectors, whose services are priced in fees and commissions, the impacts of policy consideration 3B would be essentially the same as above**. That is to say that providers of these services will no longer face hidden VAT or the need to deal with the proportional deduction rules, structural provisions and divergence across Member States. This will in turn improve market functioning, particularly when it comes to outsourcing, and remove barriers to trade on the Single Market and, to a certain extent, international competitiveness.

In the banking sector, the benefits would be less pronounced. This is because the majority of banking output (ca 73%) is comprised of interest-based services that would remain exempt, meaning that (i) the production and trade of these services, both domestically and across borders, would be unaffected and (ii) as producers of mixed outputs, banks would still need to distinguish between taxed and exempt services, determine the proportion of deductible input VAT and avail themselves to structural provisions like VAT groups to minimise distortions and tax liabilities.

That said, from the perspective of **market functioning, the impacts for the banking sector would still represent an improvement and simplification** compared to the baseline scenario, in line with the impacts on legal certainty described above. For example, since all of the problematic service definitions refer to certain types of fee-based services, this issue would fade away as a complicating factor for banks trying to determine their VAT treatment or grapple with the rules in multiple jurisdictions. Hidden VAT – and thus the scale of the related distortions and their knock-on effects – would also fall meaningfully, albeit less dramatically than for the other sectors, and to varying degrees depending on the structure of a country's banking sector and the product mix of individual banks. The distorting effects on monetary policy would also be avoided, since interest-based services (including consumer loans) would remain exempt.

While avoiding the problems of taxing interest-based services, **consideration 3B would also bring a specific risk, namely the price arbitrage** that could arise between taxed fee-based services and interest-based services in the banking sector. For example, for a loan ordinarily priced in a combination of interest margins and fees, a bank could be incentivised to shift the balance between these depending on whether the customer is a taxable business able to deduct input VAT or an end consumer. In addition to the implications for tax revenues, this would impede market functioning by making tax treatment influence behaviour. However, the combination of mitigating measures (see description in Section 11.4.1) and fact that multiple jurisdictions (e.g., Japan, Australia, New Zealand) have implemented a similar policy successfully suggest that in practice issues of price arbitrage would only materialise to a limited, indirect extent. For example, by reducing the relative cost of fee-based services for business customers with the right to deduct, the calculus of the types of financial services to purchase could shift to a degree; the opposite effect could be expected among private consumers and others without the right to deduct input VAT.

In addition, as with consideration 3A, the market benefits of this policy consideration would be incrementally greater in the variant that would also remove sectoral taxes (3B(i)a), and reduced if implemented in the forms that would leave sectoral taxes in place and / or apply revenue-neutral rather than standard VAT rates (3A(i)b and 3(ii), respectively). This is due to the higher degree of fragmentation and complexity that would persist in the tax framework. Similarly, carve-outs for essential services would increase diversity of treatment and complexity, and lead to the persistence of certain amounts of hidden VAT and the associated distortions.

14.2.6 Social impacts – Financial inclusion, access to basic services and affordability

➢ Overview

Financial services are consumed in at least some measure by nearly all Europeans, and **policy changes affecting their price could access to basic services, as well as affordability** for consumers in a more general sense.

To assess the consumer-level implications of the different options, **the aggregate B2C revenue impacts have been translated into an estimated average cost or saving per customer**, calculated by dividing the revenue effect of B2C banking services and other financial services (see Table 83) by the number of consumers in that market[666]. While this offers a helpful baseline, the reality of the financial services market is more nuanced. Because wealthier households tend to use higher-value, more complex products, they account for a disproportionate share of overall spending, meaning that for the majority of consumers the actual impact would likely be smaller than the headline numbers suggest in Table 83. Still, the estimates present a useful measure of the maximum threshold that most households might realistically expect to pay or save, which remains low for every option considered[667].

The analysis confirms that the **average per-customer impact is small under all options**. For banking consumers, costs arise under all standard-rate options regardless of whether sectoral taxes are maintained or removed: the largest additional cost falls under VAT on all services at standard rates with sectoral taxes maintained (3A(i)b), at EUR 30 per year, followed by the equivalent option with the removal of sectoral taxes (3A(i)a) at EUR 20 per year, VAT on fee-based services at standard rates with sectoral taxes maintained (3B(i)b) at EUR 14 per year, and its counterpart with sectoral taxes removed (3B(i)a) and the revenue-neutral option 3A(ii), both at EUR 8 per year. This reflects the fact that, at standard rates, the VAT applied to outputs outweighs the benefit for consumers of removing existing sectoral taxes. For 3B(ii), which entails VAT on fee-based services with revenue-neutral rates, the impacts are negligible at a cost of EUR 2 per year.

For pension fund customers, the impacts are smaller in absolute terms across the board. Costs arise under all standard-rate options: the largest are under 3A(i)b and 3B(i)b with sectoral taxes maintained at EUR 10 per year each, followed by 3A(i)a and 3B(i)a with removal of sectoral taxes at EUR 5 per year each. Consideration 3A(ii) generates a saving of EUR 5 per year for pension fund customers, despite being a cost for banking customers; 3B(ii) produces no change. The consumption of financial services is also heavily skewed towards higher income brackets, which means that impacts for Europeans with lower incomes would be far smaller than these averages, most likely bordering on negligible.

Table 83: Impact on costs for the average customer (EUR), rounded to the nearest EUR 5[668]

	Impact on B2C segment - Total cost per customer	
Variant	**Cost per banking customer (EUR/yr)**	**Cost per pension fund customer (EUR/yr)**
3A(i)a – VAT on all services, standard rates, removal of all sectoral taxes	20	5
3A(i)b – VAT on all services, standard rates, sectoral taxes maintained	30	10

[666] Since there is no comprehensive, EU-wide data on consumers of financial services, assumptions have been made using the best available proxies, following the approach in the previous study. All estimates concern Europeans aged over 15 years. For banking services, World Bank Financial Inclusion data find that approximately 95% of EU adults have a bank account, giving a customer base of approximately 340 million. For other financial services, the customer base is estimated at approximately 136 million EU adults, comprising an estimated 64 million personal pension product holders (approximately 18% of EU adults, per EIOPA Consumer Trends Report 2024) and approximately 72 million active occupational pension scheme members and beneficiaries (per EIOPA IORPs in Focus 2024, data as at end-2022/2023). The calculations also take into account the standard pass-on assumptions used throughout this report.

[667] In line with all results of the partial-equilibrium model, it should be noted that the impacts are over the longer term, while the immediate effects of any tax changes could vary and be more pronounced for certain products.

[668] In the table, positive figures indicate costs for consumers, while negative figures indicate savings.

3A(ii) – VAT on all services, revenue-neutral rates, sectoral taxes maintained	10	-5
3B(i)a – VAT on fee-based services, standard rates, removal of all sectoral taxes	10	5
3B(i)b – VAT on fee-based services, standard rates, sectoral taxes maintained	15	10
3B(ii) – VAT on fee-based services, revenue-neutral rates, sectoral taxes maintained	0	0

Source: Partial-equilibrium model and data from World Bank and EIOPA

It is therefore **unlikely that the policy changes under consideration could make substantial numbers of Europeans lose access to basic banking services**. Even under the most burdensome option for banking consumers (3A(i)b), the estimated per-customer cost of EUR 30 per year is modest, and the moderate elasticity of demand for financial services suggests that sales would remain relatively stable even where tax burdens increase. Evidence on employment impact from the macroeconomic model (discussed in section 14.2.2 below) further supports this assessment. Job losses among low-skilled workers (a proxy for lower-income households more vulnerable to financial exclusion) are not disproportionately larger than those among high-skilled workers. As low-skilled workers tend to have lower and less stable incomes, they are more at risk of losing access to basic financial services if employment or income falls. Under the considered options, overall employment effects are relatively evenly distributed and are substantially reduced under revenue-recycling scenarios, further suggesting that the proposed policy changes are unlikely to significantly increase the risk of financial exclusion.

Pension fund customers also face a low risk of financial exclusion because impacts on pension services are smaller and, in some options, neutral or positive due to revenue-neutral measures. Additionally, pension products are concentrated among higher-income households and involve long-term commitments, so small price changes are unlikely to prompt immediate behaviour changes. Overall, pension-holders are unlikely to see meaningful reductions in access to basic financial services from the options considered.

Nevertheless, given the importance of financial inclusion and ensuring that certain services remain accessible to all citizens, it is **worth investigating the potential impacts from several additional angles**. This is done below, examining in detail the impact on three specific areas – payment accounts with basic features, housing credit and pension funds – where social impacts may be more pronounced for certain consumer groups.

- ***Payment accounts with basic features***

The Payment Accounts Directive (PAD)[669] specifically addresses the risk of financial exclusion by establishing that all EU-resident consumers have a right to access a payment account with basic features, covering cash deposits and withdrawals, direct debits, credit transfers and debit card payments, at a reasonable fee. According to the latest available data, this goal is close to being achieved: over 95% of residents have access to a bank account in most Member States, and fewer than 85% in only one (Romania, with 71%)[670].

To estimate the potential price impact of the policy considerations on this service, prices for payment accounts with basic features, or the closest equivalent basic account where the national PAD comparison tool does not separately identify the designated product, have been collected from the publicly available

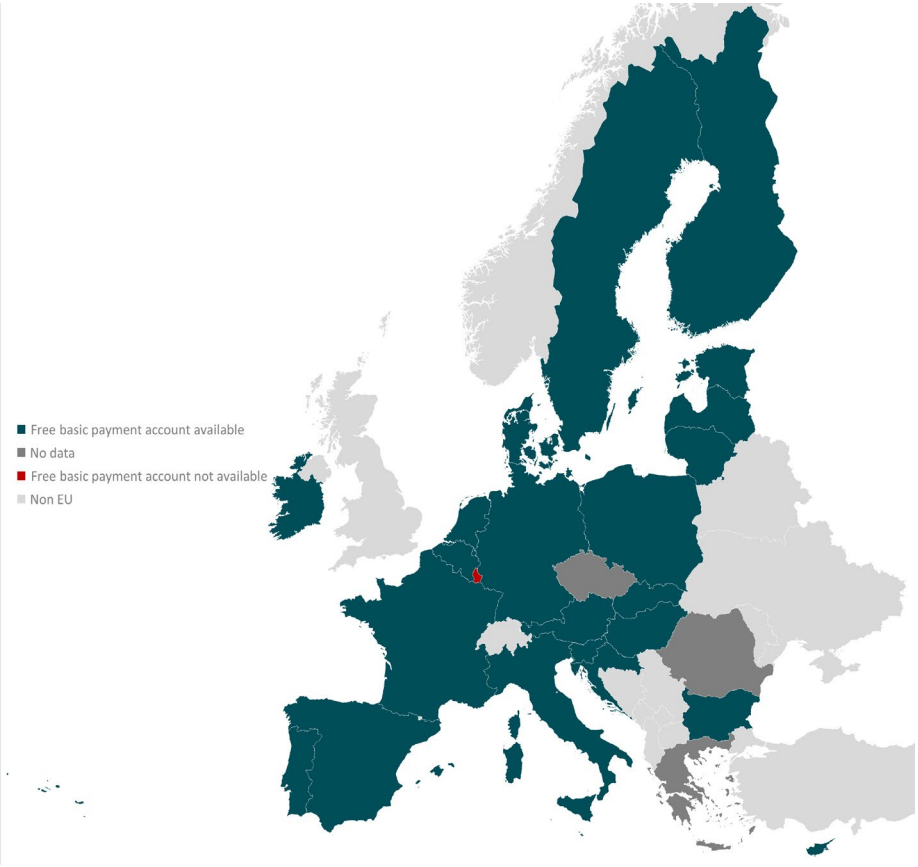
[669] Directive 2014/92/EU of the European Parliament and of the Council of 23 July 2014 on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features (Text with EEA relevance).

[670] World Bank (2025) The Little Data Book on Financial Inclusion 2025.

fee comparison tools that Member States are required to maintain under Article 7 of the PAD[671]. Both minimum and maximum prices were recorded for each Member State where data were available[672].

As shown in Figure 81 below, **almost all Member States have at least one offer of a payment account with basic features at no charge**, whether through a traditional bank, a digital banking provider, or an institution operating cross-border under the PAD framework. Luxembourg appears as an exception, though this likely reflects a limitation of the national comparison tool rather than the true market situation: the tool only covers institutions meeting a minimum market share threshold, meaning that smaller providers, including digital banks that commonly offer no-charge accounts, are not represented. In any case, the PAD framework itself provides a further backstop: all EU-resident consumers, regardless of their Member State of residence, are entitled to open a payment account with basic features offered by a credit institution operating in another Member State, including fully online providers. For the most financially constrained consumers, a qualifying account is therefore available at zero cost in practice across the entire EU, meaning that the application of VAT would not translate into any price increase for them.

Figure 81: Availability of free payment accounts with basic features



Source: Authors' elaboration based on national comparison tools

[671] Data collected from national comparison tools, on 8 May 2026. Where a comparison tool does not separately identify the PAD-designated payment account with basic features, the closest equivalent basic account available in the tool was used as a reference.

[672] For Czechia, Greece and Romania, no source equivalent to the others was identified. Instead, these Member States appear to rely on PAD-compliant comparison mechanisms for payment-account fees that are either operated by private comparison websites designated under national law which does not allow the differentiation between basic features and premium accounts (Czechia), or by public authorities providing more general fee comparison tables or tools that do not single out basic payment accounts as a distinct product category (Greece and Romania).

For consumers who currently hold a paid payment account with basic features, Table 84 below shows the **maximum estimated annual price increase** under a standard-rate VAT scenario[673]. Even considering this worst case, which adds VAT on top of current prices without any change in the underlying sectoral tax position and does not consider potential price reductions as a consequence of the input VAT deduction, the largest increase would be EUR 39.90 per year in Germany and EUR 34.64 per year in Denmark, both of which reflect the fact that these Member States have also the most expensive products available in the national comparison tools[674]. In most Member States, the estimated maximum increase falls below EUR 15 per year, and in several (Malta, Poland, Lithuania, Belgium) it remains below EUR 5.

Table 84. Maximum estimated price increase for a payment account with basic features under standard-rate VAT, by Member State, rounded to the nearest EUR 5

Country	Most expensive payment account with basic features (EUR/year)	Price increase if VAT at the standard rate (EUR/year)
AT	85	10
BE[675]	20	5
BG[676]	25	5
HR	35	5
CY	50	5
CZ	-	-
DK	200	35
EE	25	5
FI	30	5
FR	70	10
DE	300	40
EL	-	-
HU[677]	45	10
IE[678]	0	0
IT	70	10
LV	110	15
LT	25	5
LU[679]	60	5
MT	10	0
NL	120	20
PL	10	0
PT	65	10

[673] This was calculated by selecting, out of the options for payment accounts with basic features that offered the most expensive price and applying VAT at the 2026 standard rate to it. The calculations also take into account the standard pass-on assumptions used throughout this report.

[674] These figures should be taken with some caution, since in certain Member States the maximum-priced product in the comparison tool may reflect an account with features that go somewhat beyond the basic minimum, meaning those upper bounds may overstate the true price impact on a strictly defined payment account with basic features.

[675] The maximum fee of EUR 20.34 per year reflects the statutory ceiling applicable from 1 January 2026.

[676] The figure shown reflects the average (not the maximum) annual fee for opening and maintaining a current account with a debit card in euros, as published by the Bulgarian National Bank.

[677] The fee ceiling for the *alapszámla* is set by statute at 0.5% of the preceding year's gross monthly minimum wage (HUF 16,008 per year until 20 June 2026, converted at the EUR/HUF exchange rate of 8 May 2026).

[678] In Ireland, basic bank accounts provide fee-free everyday banking conditionally, typically for the first 12 months and below an income threshold.

[679] The comparison tool only covers institutions with at least 25 branches in Luxembourg and holding at least 2.5% of covered deposits, or institutions that have expressly requested inclusion.

RO	-	-
SK[680]	35	5
SI[681]	60	10
ES	95	15
SE	140	25

Source: Authors' elaboration based on comparison tools and published VAT rates

Further, the available evidence[682] suggests that the price of financial services is not a key cause of financial exclusion. This makes it especially unlikely that changes to the VAT exemption would in fact exacerbate financial exclusion.

➢ *Housing credit*

Across the euro area, only 27% of households hold mortgage debt overall, with mortgage holdings concentrated disproportionately among the top two income quintiles[683]. Among those who do borrow, the typical EU mortgage holder spends around 14.3% of their income on mortgage repayments[684], although this share is likely higher for lower-income households. Additionally, between 2017 and 2021, the share of indebted households fell among higher-income groups while rising among younger and non-employed households, signalling that the pool of active mortgage borrowers is already shifting toward less financially stable profiles.

The share of mortgage-holding households spending more than 40% of their disposable income on housing costs varies widely across Member States. The EU average stands at 5.0%, reaching 20.9% in Greece, 13.7% in Bulgaria, and 14.5% in Germany, while remaining below 3% in France, Belgium and Romania. Bulgaria's rate more than doubled in just two years, from 4.6% in 2022 to 13.7% in 2024, and Estonia saw a similarly sharp rise from 1.7% to 6.6% over the same period.

Lower-income mortgage holders are also more likely to hold flexible-rate mortgages, making them more exposed to rate increases. Households that combine both risk factors (i.e.: holding a flexible-rate mortgage and already spending more than 40% of gross income on debt service) represent less than 1% of all euro area households overall. But within the bottom income quintile specifically, this share nearly doubles to 2%[685]. For some of these consumers, there is a risk that even modest price increases could put mortgage credit out of reach or make continued loan payments difficult, especially if the addition of VAT is accompanied by unrelated increases in interest rates.

➢ *Pension funds*

Private pension participation is limited and more prevalent among higher earners. Only 20% of Europeans participate in occupational pension schemes and just 18% hold a personal pension product[686]. Additionally,

[680] The account shown (*štandardný účet*) is legally capped at EUR 3 per month. A separate means-tested free basic account also exists for low-income consumers.
[681] The fee cap for the basic payment account is set by Banka Slovenije at EUR 4.90 per month (EUR 58.80 per year) for standard consumers, and EUR 1.47 per month for socially eligible consumers.
[682] European Commission, (2010) EU-SILC 2008 Module on Over-Indebtedness and Financial Exclusion, Assessment of the implementation.
[683] European Commission. (2025). The impact of interest rate changes on euro area households' net interest income. Directorate-General for Economic and Financial Affairs. https://economy-finance.ec.europa.eu/economic-forecast-and-surveys/economic-forecasts/spring-2025-economic-forecast-moderate-growth-amid-global-economic-uncertainty/impact-interest-rate-changes-euro-area-households-net-interest-income_en (last accessed May 2026)
[684] European Central Bank (2023) Household Finance and Consumption Survey: Results from the 2021 wave, ECB Statistics Paper Series No. 46.
[685] European Commission. (2025). The impact of interest rate changes on euro area households' net interest income. Directorate-General for Economic and Financial Affairs. https://economy-finance.ec.europa.eu/economic-forecast-and-surveys/economic-forecasts/spring-2025-economic-forecast-moderate-growth-amid-global-economic-uncertainty/impact-interest-rate-changes-euro-area-households-net-interest-income_en (last accessed May 2026).
[686] European Insurance and Occupational Pensions Authority (EIOPA) (2024), Consumer Trends Report 2024, EIOPA-BoS-24.

occupational and personal pension products are disproportionately held by higher-income households, while lower-income households, where they participate at all, tend to hold only subsidised or mandatory contribution products with smaller and more irregular contributions. National rates of non-participation in supplementary pension saving also vary largely. In Sweden and the Netherlands, fewer than about 10% and 1% of pensioners rely solely on a statutory pension. By contrast, in Romania, Bulgaria, Hungary, Latvia, Cyprus and Croatia, over 95% of pensioners do. Indeed, 19% of personal pension product holders already cite high costs and fees as the reason for not renewing or increasing contributions[687].

In light of this, the estimated impacts presented in Table 84 above are broadly reassuring: the estimated effect on pension fund consumers produces only modest costs increases under the standard-rate considerations, 3A(i) and 3B(i) in both their removal and maintained variants, which generate costs ranging from EUR 5 to EUR 10 per year. Only under these considerations does the potential impact on participation rates in Member States warrant closer monitoring, especially where pension saving is both price-sensitive and already limited to a narrow base.

14.3 Policy Consideration 3C –Introduction of an FAT for all financial services, with VAT zero-rating and removal of sectoral taxes

14.3.1 Impacts on sales and tax revenues

- ***First-order impact on sales of financial services (partial-equilibrium model)***

Under Consideration 3C, which combines VAT zero-rating with a Financial Activities Tax (FAT) and the removal of IPTs and other sector-specific levies, the **overall impact on demand for financial services is limited at aggregate level but more marked across sectors and market segments**. Consideration 3A and 3B focus on lowering effective taxation through the removal of hidden VAT and sectoral taxes, whereas Consideration 3C is designed to harmonise the tax treatment of financial services through VAT zero-rating and the introduction of a revenue-neutral FAT. As a result, the aggregate effect is relatively contained, but this masks more substantial and partly offsetting effects between B2B and B2C transactions.

Although the same pass-through and elasticity assumptions are applied across tax instruments, VAT and FAT differ in how they affect prices: VAT is levied on transactions and directly enters prices, whereas FAT is applied at the firm level and does not translate into prices in the same mechanical way, resulting in more limited effects on final demand.

Table 85. Total impact on sales of harmonising sectoral taxes, as % of current sales and in EUR billion (partial equilibrium)

Impact on sales of harmonising sectoral taxes	Total impact (B2B + B2C)				
	As % of current sales				EUR bn
	Banking	Insurance	Other fin. services	Total	Total
3C – FAT and VAT-ZR all financial services	-2%	4%	-7%	<1%	-3

Looking first at the total impact across B2B and B2C combined, Consideration 3C leads to **a small negative effect on total sales**, with sales decreasing by less than -1%, corresponding to approximately EUR -3 billion. At sector level, the results are heterogeneous: sales increase in insurance (+4%), while they decrease in banking (-2%) and more substantially in other financial services (-7%). These offsetting changes result in a near-zero aggregate impact.

For the **B2B segment**, Consideration 3C leads to a **more pronounced negative effect on demand** (–3%), corresponding to around EUR -13 billion. This decline is driven mainly by lower demand for other financial services (–11%) and, to a lesser extent, banking services (–3%), while demand for insurance rises (+4%). This

[687] EIOPA (2024), Consumer Trends Report 2024, European Insurance and Occupational Pensions Authority, Frankfurt am Main.

contrasts with the more positive B2B effects observed under Considerations 3A and 3B. While VAT zero-rating removes VAT from final prices, the introduction of a revenue-neutral FAT changes the deductibility structure of the tax system. The consideration 3C shifts from a regime in which most input tax was non-deductible to one in which all tax under FAT is non-deductible, increasing the effective tax burden on B2B transactions while lowering it for household consumption.

Table 86. B2B impact on sales of harmonising sectoral taxes, as % of current sales and in EUR billion (partial equilibrium)

Impact on sales of harmonising sectoral taxes	Impact on B2B segment				
	As % of current sales				EUR bn
	Banking	Insurance	Other fin. services	Total	Total
3C – FAT and VAT-ZR all financial services	-3%	4%	-11%	-3%	-13

Indeed, **the B2C segment shows a positive effect on demand**, with total sales increasing by around +3%, equivalent to approximately EUR +11 billion. This increase is driven primarily by insurance (+4%) and, to a lesser extent, other financial services (+2%) and banking (+1%). Compared with Considerations 3A and 3B, where B2C sales often remain broadly neutral or decline under standard-rate scenarios, the positive B2C impact under Consideration 3C is more marked. This reflects the fact that VAT zero-rating lowers consumer prices, while the introduction of the FAT only partly offsets this effect because the FAT is not translated into final prices as directly as VAT.

Table 87. B2C impact on sales of harmonising sectoral taxes, as % of current sales and in EUR billion (partial equilibrium)

Impact on sales of harmonising sectoral taxes	Impact on B2C segment				
	As % of current sales				EUR bn
	Banking	Insurance	Other fin. services	Total	Total
3C – FAT and VAT-ZR all financial services	1%	4%	2%	3%	11

- ***First-order impact on tax revenues (partial-equilibrium model)***

The harmonisation scenario of **Consideration 3C** lead to **substantial redistributions of tax revenues across instruments and sectors**, while resulting in more limited net changes in total revenues than might be expected from the individual components. These results reflect the direct sensitivity of tax revenues to changes in tax design, combined with the replacement of VAT and IPT revenues by FAT-based revenues. By definition, **Consideration 3C is neutral from an overall tax revenue perspective**: losses in VAT revenues are exactly compensated by increases in non-VAT tax revenues

Table 88. Total impact on government tax revenues of harmonising sectoral taxes, in EUR billion (partial equilibrium)

Impact on revenues of harmonising sectoral taxes	Total impact (B2B + B2C)			
	EUR bn			
	Banking	Insurance	Other fin. services	Total
Impact on VAT revenues				
3C – FAT and VAT-ZR all financial services	-37	-19	-13	-69
Impact on non-VAT tax revenues				
3C – FAT and VAT-ZR all financial services	59	-17	27	69

Under **Consideration 3C**, VAT revenues decrease significantly across all sectors (EUR –69 billion in total), reflecting the application of VAT zero-rating to all financial services. This decline is fully offset by an increase in **non-VAT revenues (EUR +69 billion)**, driven by the introduction of revenue-neutral FAT and VAT rates.

At the sectoral level, these changes are unevenly distributed. The largest decline in VAT revenues occurs in the **banking sector (EUR –37 billion)**, followed by insurance (EUR –19 billion) and other financial services (EUR –13 billion). These losses are more than offset by increases in non-VAT revenues in banking (EUR +59 billion) and other financial services (EUR +27 billion), while the insurance sector experiences a similar decrease (EUR –17 billion), reflecting the removal of IPT revenues and their replacement through FAT.

Table 89. B2B impact on government tax revenues of harmonising sectoral taxes, in EUR billion (partial equilibrium)

Impact on revenues of harmonising sectoral taxes	Impact on B2B segment			
	EUR bn			
	Banking	Insurance	Other fin. services	Total
Impact on VAT revenues				
3C – FAT and VAT-ZR all financial services	-18	-3	-8	-29
Impact on non-VAT tax revenues				
3C – FAT and VAT-ZR all financial services	43	-5	24	62

For the **B2B segment**, VAT revenues decrease significantly by EUR –29 billion, reflecting the combined effect of VAT zero-rating and input deductibility. These losses are more than offset by increases in non-VAT revenues (EUR +62 billion), leading to a **net increase in total revenues in the B2B segment**. This reflects the fact that FAT is effectively levied on value added within firms and is not subject to deduction in the same way as VAT, thereby generating additional revenue from business activity. Compared to Considerations 3A and 3B, where the B2B segment systematically generated net revenue losses due to input VAT deductibility, Consideration 3C leads to a **reversal of this pattern**, with B2B becoming a net contributor to revenue increases.

Table 90. B2C impact on government tax revenues of harmonising sectoral taxes, in EUR billion (partial equilibrium)

Impact on revenues of harmonising sectoral taxes	Impact on B2C segment			
	EUR bn			
	Banking	Insurance	Other fin. services	Total
Impact on VAT revenues				
3C – FAT and VAT-ZR all financial services	-20	-16	-5	-40
Impact on non-VAT tax revenues				
3C – FAT and VAT-ZR all financial services	16	-12	3	7

Oppositely, the **B2C segment** exhibits **net revenue losses** amounting to EUR –40 billion in terms of VAT revenues, partially offset by increases in non-VAT revenues (EUR +7 billion). Overall, this results in a **net decrease in total revenues in the B2C segment** (EUR -33 billion). The negative impact on revenues from the B2C segment reflects the fact that VAT zero-rating removes taxation at the point of final consumption, while FAT does not fully replicate this mechanism in terms of incidence on households.

➢ *Insight from the sensitivity analysis*

To assess the robustness of the findings to alternative parameter values, this section **reports the comparison of the total estimated impacts across four scenarios (core and the three sensitivity scenarios)**. This comparison makes it possible to evaluate how sensitive the estimated impacts are to the values of the pass-through and demand elasticity parameters for each policy consideration.

For sales of financial services under Consideration 3C, the aggregate impact remains limited across scenarios, ranging from approximately EUR -1 billion to EUR -5 billion. The smallest effect is observed under S3, where demand is assumed to be less responsive to price changes, while the largest effect is observed

under S4, where demand is more price responsive. This confirms that the **overall sales impact of Consideration 3C remains relatively contained**, although the effect is not negligible.

Table 91. Impact on sales: comparison of total impact across sensitivity scenarios

Impact on sales of removing the VAT exemption and/or sectoral taxes	Impact (B2B + B2C) - Total in EUR bn			
	Core (S1)	S2	S3	S4
3C – FAT and VAT-zero rating all services, revenue-neutral rates, removal of all sectoral taxes	-3	-2	-1	-5

The impact on **government revenues under Consideration 3C** remains very limited, with total differences around or smaller than EUR 1 billion in absolute value. As for Consideration 3A and 3B, different demand responses under the sensitivity assumptions have only a limited effect on aggregate revenues.

Table 92. Impact on government revenues: comparison of total impact across sensitivity scenarios

Impact on revenues of removing the VAT exemption and/or sectoral taxes	Impact (B2B + B2C) - Total in EUR bn			
	Core (S1)	S2	S3	S4
3C – FAT and VAT-zero rating all services, revenue-neutral rates, removal of all sectoral taxes	<1	<1	1	-1

14.3.2 Macroeconomic impacts

For Consideration 3C, results from the macroeconomic model point to a **very limited overall macroeconomic impact**, as shown in Table 93. Under the no-recycling scenario, GDP increases slightly relative to baseline, by around EUR +8 billion, corresponding to less than 0.1% overall. Final consumption and investment also increase modestly, by EUR +14 billion (0.1%) and EUR +3 billion (0.1%) respectively. At the same time, the trade balance deteriorates slightly, by around EUR –12 billion (-0.07 percentage points of GDP). Taken together, this suggests a **broadly neutral aggregate effect**, with small positive effects on domestic demand offset by a slight weakening in the external balance.

When revenues are recycled through reductions in VAT rates on other goods and services, the aggregate effects become even **smaller overall**. GDP remains broadly unchanged relative to baseline, while final consumption increases modestly by around EUR +5 billion and investment by EUR +1 billion. The trade balance continues to deteriorate slightly, by around EUR –8 billion. Compared with the no-recycling scenario, recycling through lower VAT rates therefore appears to moderate both the positive domestic demand effects and the negative external balance effects.

When revenues are recycled through lump-sum transfers to or from households, the GDP impact becomes slightly negative overall, declining by around EUR –3 billion. Final consumption remains at similar levels to baseline while the trade balance deteriorates by around EUR –7 billion. Overall, the macroeconomic effects under Consideration 3C remain **very limited across all recycling scenarios**, with changes in GDP components remaining close to zero in percentage terms.

Table 93. Total impact of the harmonisation of key sectoral taxes on GDP and its components (macroeconomic model) – in EUR billion, 2030 deviation from baseline

Impact on GDP components 2030 deviation from baseline		EUR bn (% change between baseline and 2030)			
Consideration	Recycling	GDP	Final consumption	Investment	Trade balance*
	No	8 (<0.1%)	14 (0.1%)	3 (<0.1%)	-12 (-0.07)

3C – FAT and VAT-ZR all financial services	Reduced VAT rates	<1 (<0.1%)	5 (<0.1%)	1 (<0.1%)	-8 (-0.04)
	Lump-sum transfers	-3 (<0.1%)	<1 (<0.1%)	3 (<0.1%)	-7 (-0.04)

** Trade balance surplus in GDP points difference from the status quo scenario. Detailed impacts of policy considerations on exports and imports are shown in Annex 5*

The **employment effects under 3C are likewise limited at aggregate level**. Under the no-recycling scenario, whole-economy employment increases by around 122 thousand jobs (+0.1 % relative to baseline), indicating a very small material effect on total employment in the EU economy by 2030 (see Table 94). The positive employment effects are distributed across both high-skilled and low-skilled workers, with increases of around 44 thousand and 78 thousand jobs respectively, which suggests a very slightly positive distributional effect on the economy.

When revenues are recycled through reductions in VAT rates, aggregate employment effects become smaller overall, with total employment increasing by around 68 thousand jobs. This includes increases of around 26 thousand high-skilled jobs and 42 thousand low-skilled jobs. Under the lump-sum transfer scenario, employment effects are smaller again, with total employment increasing by around 43 thousand jobs relative to baseline.

Taken together, the results suggest that Consideration 3C remains broadly **macroeconomically neutral under all recycling scenarios**, with only small changes in GDP components and aggregate employment relative to baseline. While low-skilled workers experience slightly larger employment gains, these differences are small and do not point to meaningful distributional effects.

Table 94. Total impact of the harmonisation of key sectoral taxes on employment (macroeconomic model) – in thousands of employees

Impact on employment 2030 deviation from baseline		Thousand employees (% change between baseline and 2030)		
Consideration	**Recycling**	**Total employment**	**High-skilled employment**	**Low-skilled employment**
3C – FAT and VAT-ZR all financial services	No	122 (0.1%)	44 (0.1%)	78 (0.1%)
	Reduced VAT rates	68 (<0.1%)	26 (<0.1%)	42 (<0.1%)
	Lump-sum transfer	43 (<0.1%)	17 (<0.1%)	26 (<0.1%)

Similar to total employment, sectoral employment effects remain very limited overall. Employment increases in insurance, while declining in banking and, to a lesser extent, in other financial services, resulting in a small positive net effect across the financial sector (+13 thousand jobs across the financial service sector). More details on sectoral employment effects are shown in Annex 5.

14.3.3 Impacts on legal certainty

The impacts of leaving the current arrangements in place (i.e., the status quo) would be the same as described for consideration 3A above. In essence, the uncertainty and compliance issues of the VAT exemption and related tax fragmentation would not only persist, but get worse over time. This is because technological change and evolving business models favour longer supply chains and the emergence of services whose status as exempt or taxed becomes harder to define.

Unlike consideration 3A, this consideration **aims to simplify the tax framework by replacing VAT with the FAT**. The targeted consultation revealed intense scepticism that the FAT would engender certainty or simplify compliance, with essentially no stakeholders voicing support for it. However, this was possibly due to a lack of familiarity, since real-world examples of such a tax are few and not widely known, as well as a perceived risk that, once in place, the FAT could be used in raise additional tax revenues. This is not the case for the consideration under review, which focuses on a revenue-neutral tax rate.

In practice, **the mechanism of the FAT is simple and this is in fact its main advantage**. As a tax on added value (defined as the sum of profits and remuneration costs), the tax basis consists of elements that companies already record and report on in a systematic and uniform manner. While any major tax change

is liable to create some uncertainty and require adjustment during its introductory phase, there is no reason to expect this would persist over time. Based on its simplicity and the lack of implementation problems with similar taxes, including the FAT in Norway and IRAP in Italy (see Section 6.6), as well as the salary taxes on exempt sectors in Denmark and France (which use a similar mechanism)[688], a net improvement in legal certainty would be expected. As explained in Section 11.4, the fact that the FAT would be applied at entity level to all turnover of qualifying financial institutions, rather than at transaction level, avoids the risk of unclear boundary areas for qualifying types of services. The coupling of the FAT with VAT zero-rating of financial services, and the removal of IPTs, bank levies and payroll taxes would represent additional simplification and further contribute to this improvement. In particular, fully restoring the right of deduction for providers of financial services would eliminate the need to deal with the rules for proportional deduction, the most complex and problematic aspect of the current exemption framework.

14.3.4 Impacts on regulatory costs

Policy consideration 3C differs from considerations 3A and 3B in that it combines the zero-rating of financial services for VAT purposes with the introduction of a harmonised FAT and the removal of several existing national sectoral taxes, notably IPTs, sector-specific payroll taxes, and levies for financial institutions. From a **VAT compliance perspective**, **zero-rating financial services would largely have the same administrative implications as removing the exemption**, as financial institutions would obtain a full right to deduct input VAT. Consequently, the need to apply the proportional deduction rules would disappear and the remaining VAT compliance obligations would broadly correspond to those under a standard VAT treatment.

Unlike under considerations 3A and 3B, the application of a zero VAT rate would likely place many financial institutions in a structural refund position, as they would recover input VAT while charging little to no VAT on outputs. This could lead to somewhat more frequent refund claims and potentially greater interaction with tax authorities, including the need for increased scrutiny during audits. However, these administrative aspects are generally not considered a major compliance burden when compared to the complexities associated with managing partial exemption and proportional deduction rules under the current regime.

In line with this reasoning, the expected changes in VAT-related administrative costs are estimated to be broadly in line with those presented under policy considerations 3A. **Applying the zero-rate and FAT to all financial services would result in savings similar to those estimated under consideration 3A**, meaning around EUR 190 million to EUR 570 million.

In addition to the changes in VAT compliance, policy consideration 3C would entail a full **removal of sectoral taxes**. The abolition of IPTs, bank levies, and other nationally imposed sectoral taxes would eliminate the administrative burdens associated with these taxes in their entirety. Based on the compliance cost estimates presented above, this full removal is expected to generate **annual savings of up to EUR 870 million at EU level**.

At the same time, applying VAT to financial services, even at a zero rate, would **remove certain simplifications** currently associated with the exemption, notably exemptions from invoicing and reporting requirements. As under policy considerations 3A and 3B, the disappearance of these simplifications would generate **additional administrative burdens estimated at roughly EUR 140 million per year** if the exemption were removed for all services. Table 95 provides an overview of the estimated administrative cost savings under policy consideration 3C.

A key difference compared with the other policy considerations is the **introduction of a harmonised EU-wide FAT**. The establishment of such a tax would create new administrative obligations for financial institutions. While the precise level of these costs is uncertain, particularly given that such an EU-wide tax measure has not yet been implemented before, they are expected to be relatively limited. This reflects the comparatively straightforward design of the FAT, which is typically levied on readily identifiable bases such

[688] While financial services providers from these countries taking part in the targeted consultation complained about these taxes, it was with regard to the fiscal effects rather than about the implementation mechanism or any legal uncertainty as such.

as profits and/or remuneration and can largely build on existing accounting and reporting systems. As a result, although some additional administrative effort would be required, both in terms of initial implementation and ongoing compliance, these costs are not expected to be significant relative to the overall compliance burden faced by the sector.

The savings can also be considered in terms of typical companies in the sector. This would vary again across the three main types of entities analysed – insurers, banks, and asset managers. The savings for banks and insurance companies are expected to largely mirror those described under consideration 3A. This leads to an estimated net saving of roughly EUR 50,000 up to over EUR 300,000.

Table 95. Administrative cost savings under policy consideration 3C

		VAT compliance savings (EUR million)	Sectoral tax compliance savings (EUR million)	Additional admin costs (EUR million)	Total
3C	Lower bound	190	870	-140	**920**
	Upper bound	570	870	-140	**1,300**

Taken together, these elements suggest that the net administrative cost impact of policy consideration 3C is subject to greater uncertainty than under considerations 3A and 3B. While the broader removal of sectoral taxes could lead to substantial administrative cost savings, the introduction of a new EU-wide tax would simultaneously generate additional administrative burdens. The overall impact on administrative costs would therefore depend on the precise design of the FAT and the scope of sectoral tax removal.

- ***Tax authorities***

For tax authorities, policy consideration 3C would have implications broadly similar to those described for considerations 3A and 3B, but with some additional elements. As under those considerations, the removal of the VAT exemption would eliminate the need to administer and verify complex proportional deduction rules. However, the **application of a zero VAT rate would likely result in an increase of the number and volume of refund claims** handled by tax administrations and may lead to somewhat greater scrutiny of refund requests during audits.

A more significant **administrative implication for tax authorities** under this policy consideration **would arise from the initial introduction of a harmonised FAT**. Establishing such a tax would require Member States to develop administrative systems for the assessment, collection and monitoring of the new tax base. This could entail one-off implementation costs as well as ongoing enforcement responsibilities, such as processing tax declarations, conducting audits and ensuring consistent application of the rules. The scale of these costs would depend heavily on the final design of the FAT and the degree to which its administration could build on existing tax reporting frameworks.

Overall, while policy consideration 3C would introduce certain new administrative tasks, including an increase in VAT refunds and the enforcement of a new sectoral tax, the removal of complex exemption-related provisions would simultaneously simplify other aspects of VAT enforcement. As under considerations 3A and 3B, the overall regulatory impact for tax authorities is therefore expected to remain moderate and manageable within the broader context of VAT administration.

14.3.5 Market impacts

From the perspective of market functioning, the main problem with the current tax framework – the VAT exemption in particular – is that it breaks VAT neutrality by taxing intermediate rather than end consumption. This privileges in-house production over the purchase of inputs, and – since hidden VAT is borne regardless of eventual supplies to customers – increases risks for financial institutions.

Consideration 3C would address these issues, but only to a partial extent. On the one hand, shifting the tax base from hidden VAT on inputs to profits and remuneration, and restoring VAT deduction rights

on input costs, would reduce the incentive towards in-house, rather than outsourced production. This is an important benefit. However, because the FAT is not a cascading, fractionated tax, the costs would remain invisible to customers at the transaction level. In other words, invoices would not show the tax associated with the FAT. Assuming the overall tax burden is similar to the current situation (for example, using the revenue-neutral rates used for this assessment), this would have little bearing on the B2C segment. But taxable B2B customers, including the other providers of financial services who consume a significant share of sectoral output as intermediate consumption, would bear a hidden, non-deductible tax. Since the FAT is partly based on remuneration costs, it can be considered a tax on input costs, which goes against neutrality principles. In these respects, the FAT does not represent improvement, and contrasts unfavourably with the tax changes in consideration 3A and 3B.

In other words, irrespective of the technicalities of implementation discussed above (Section 14.3.3 on legal certainty), the **consideration 3C is less neutral with regard to business practices and value chains than a fractionated VAT system**.

Aside from the introduction of the FAT and changes to VAT, consideration 3C would also remove (where applicable) IPTs, bank levies and salary taxes. While the fiscal impacts of these taxes have been found distorting in some circumstances (see discussion in Section 8.1), the revenue-neutral character of the policy change considered here focuses on effects of the taxation mechanisms – which generally have not been identified as problematic – and fragmentation. The replacement of these diverse and varied taxes with a harmonised EU-wide FAT and VAT framework would **markedly increase uniformity, making it easier to trade on the Single Market by removing a layer of complexity** to operating in multiple jurisdictions. Even if, as described in the analysis of considerations 3A and 3B, other factors are more important brakes on cross-border trade, EU policies aim to gradually address these, making tax fragmentation important to address in turn. A similar dynamic would prevail for international competitiveness, which improved market functioning and reduced barriers to trade on the Single Market, could be expected to support.

14.3.6 Capital Duty Directive and soft coordination

While not a fully-fledged policy consideration, two other measures for increased coordination and harmonisation of sectoral taxes are also explored, which could be implemented separately or as complements to a wider policy package.

The first of these relates to the **Capital Duty Directive (CDD)**. Though generally prohibiting indirect taxes on the raising of capital, the CDD contains a derogation allowing Member States applying such measures on 1 January 2006 to continue doing so subject to strict conditions. In addition to the four Member States (Greece, Poland, Portugal and Spain) availing themselves of the derogation, several other Member States apply taxes that are similar or fall into a grey area (see overview in Section 11.4). A complementary measure as part of a policy initiative could remove the derogation, effectively ending the application of capital duties in the EU.

The CDD and extant capital duties were not analysed in depth for the study and thus their economic and practical implications have not been mapped. However, it is noteworthy that, while all participants in the targeted consultation were asked to name relevant sectoral taxes in the financial sector and any issues caused by these, capital duties were not raised. This suggests limited perceived impacts in areas like legal certainty, compliance costs, the ability to trade in the Single Market and the competitiveness of EU financial institutions. Moreover, tax fragmentation in general was only found to be a minor contributor to legal uncertainty and the low volumes of cross-border trade. The continued existence of capital duties in certain Member States would seem consistent with this picture. As such, **removing the derogation would be likely to reduce tax fragmentation and – at a minor scale proportionate to the problems it causes – support market functioning and cross-border trade**. That said, it would also remove a source of tax revenues for the countries concerned, which would require careful consideration.

The second perspective pertains to the **coordination of financial-sector taxes by non-binding means, such a Commission Recommendation**. The rationale for this is that, while the study has revealed considerable fragmentation of taxes other than VAT and taxes like IPTs that have been introduced to offset the effects of the VAT exemption, taxation remains a core national competence. Therefore, binding action

on a wider range of taxes could be difficult to justify legally and agree on. Instead, with a view to supporting the objectives of the initiative (and related CMU and SIU policies), a non-binding initiative would provide guidance on the design and implementation of sectoral taxes, and on the situations in which they should and should not be used.

Looking at existing Commission Recommendations in the field of taxation, it seems that these can have some effect on raising an issue on the political agenda, and potentially lead to some convergence, but that approaches will vary considerably until binding action is taken. Such dynamics can be observed in the 2012 Recommendation on aggressive tax planning[689], which was later taken forward in the Anti-Tax Avoidance Directive[690], and the 2009 Recommendation on withholding tax relief procedures[691], where progress deemed insufficient helped justify the FASTER Directive adopted in 2024[692].

Leading from this, **a non-binding measure on sectoral taxes seems like a relatively low-risk endeavour that could pay off at a later time**. In the first instance, it would raise awareness of the importance of the fragmented tax framework as a barrier to the achievement of EU policy objectives. While unlikely, this could influence decisions at national level on the design or implementation modalities of certain taxes. Then, if the desired effects do not materialise, a later evaluation will show that binding legislation is needed, thereby bolstering its case. In other words, as a standalone initiative, a non-binding measure is unlikely to achieve significant impacts, but over the long term it could lay the ground for later, more substantial, action, and thereby make an important contribution.

14.4 Conclusions

Given the structural nature of the changes, impacts were assessed across several areas, namely impacts on demand (i.e., sales) for financial services and government revenues (which have knock-on social impacts); macroeconomic impacts on the wider economy; impacts on legal certainty; impacts on regulatory costs; impacts on market functioning; and social impacts.

The **wide range of reforms assessed would suggest a similar range in terms of impacts**, and this is exactly what was found. The variation runs along two main axes:

- For the **economic impacts**, these are relatively moderate considering the importance of the reforms assessed, with the impacts differing depending on the VAT rates applied, and whether sectoral taxes are removed or maintained, though certain cross-cutting themes also emerge within sectors and market segments.:
    - Considerations 3A(i)a and 3B(i)a, which combine the removal of the VAT exemption with the removal of sectoral taxes, generate increases in sales and falls in government revenues. This is because the application of standard-rate VAT to financial services outputs does not fully compensate for the removal of sectoral taxes and restoration of the right to deduct input VAT. For the same reason, considerations 3A(i)b and 3B(i)b, which remove the VAT exemption while retaining sectoral taxes, lead to falls in sales and increases in government revenues. The revenue-neutral considerations 3A(ii), 3B(ii) and 3C leave both aspects essentially unchanged in aggregate.
    - In banking, impacts on government revenues and (especially) sales are limited across all policy considerations and variants, since the countervailing changes in tax treatment roughly cancel each other out. For insurance, the importance of sectoral taxes (IPTs) means that sales increase, and government revenues fall, in considerations 3A(i)a and 3B(i)a, since these taxes are removed; the inverse happens for considerations 3A(i)b and 3B(i)b, where sectoral taxes are maintained. Impacts from the revenue neutral variants 3A(ii), 3B(ii) and

[689] Commission Recommendation of 6 December 2012 on aggressive tax planning (2012/772/EU).

[690] Cf. The Staff Working Document accompanying the Communication from the Commission to the European Parliament and the Council – Anti Tax Avoidance Package: Next Steps towards delivering effective taxation and greater tax transparency in the EU (SWD(2016) 6 final.

[691] Commission Recommendation of 19 October 2009 on withholding tax relief procedures (2009/784/EC).

[692] Cf. Impact assessment report on the new EU system for the avoidance of double taxation and prevention of tax abuse in the field of withholding taxes (SWD(2023) 216 final.

3C are modest in the insurance sector. For other financial services, the largely B2B nature of supplies means that the application of standard and neutral VAT would result in drops in revenue, since eliminating hidden VAT would more than compensate the imposition of VAT on outputs, much of which would be deducted by business customers. Government revenues in this sector would also increase under 3C.

- In all cases, demand would inversely follow the changes in government revenue, albeit at a reduced scale due to the incomplete pass-through to customers, and price elasticity of demand for services.
- Looking at market segments, the considerations assessed are generally more favourable for business customers with the right of deduction. This is because they benefit from reduced costs for providers of financial services while deducting the input VAT incurred. For its part, the B2C segment (which includes non-taxable government authorities) experiences reduced sales even for sectors and variants where sales increase or are neutral overall.
- The **macroeconomic model** shows that, once revenues are recycled into the economy, the overall impacts become much more limited. GDP effects are generally close to neutral, becoming positive in most scenarios, while the trade balance improves across all variants of considerations 3A and 3B. Final consumption becomes positive when revenues are returned to households through lump-sum transfers, reflecting the stronger support to household purchasing power under this recycling mechanism. The impacts on employment are also small and substantially moderated by either type of revenue recycling. For consideration 3C, the macroeconomic impacts remain close to neutral overall.
- Regarding **social impacts**, the limited average impact per customer means that the potential for any of the policy considerations to cause financial exclusion or meaningfully affect the affordability of basic financial services is very low. These costs could be fully offset by retaining the VAT exemption for certain services, but this would come at the cost of additional regulatory complexity and lost VAT revenues.

- The **other types of impacts relate more to functioning of the tax framework**, and whether the policy changes considered improve consistency and clarity, simplify compliance, and increase tax neutrality vis-à-vis value chains in the sector. As such, the more positive impacts are found among the changes that bring the financial sector closest to the normal VAT system and reduce the space for discrepancies between Member States, while avoiding implementation difficulties.
  - **Consideration 3A would fully eliminate the distortions of the VAT exemption**, and reduce compliance costs across the board. This would in turn increase the scope for more efficient value chains based on outsourcing / groupsourcing and remove the disincentive to investment in innovative services, particularly for niche SMEs and start-ups. Cross-border trade and the competitiveness of the sector would also be supported, though the impacts would be limited to the wide variety of other factors at play. This consideration was also not found to create problems such as competition advantages for third-country suppliers or specific types of firms, or possibilities for manipulation from a state-aid perspective. On the other hand, this consideration also brings its own complexity and potential to create uncertainty, due to the difficulties of applying VAT to interest-based services and related implications for monetary policy.
  - Consideration 3B would have similar effects for insurance and other financial sectors, though for the banking sector it would still be necessary to distinguish (taxed) fee-based and (exempt) interest-based services, retaining a degree of the current complexity and distortions. In contrast, the risk of price arbitrage can be mitigated and is thus unlikely to cause implementation problems.
  - **The variants for neutral VAT rates (3A(ii) and 3B(ii) would also add a layer of complexity** because of the need to define and enforce the relevant services, as would the carve-outs considered to ensure access to basic services.

- For its part, **the FAT (consideration 3C) would represent a simplification** compared to the current tax framework and increase the coherence of the tax framework while reducing compliance costs to a certain extent. However, because the costs of the tax would be embedded in financial services outputs, it would not fully resolve the existing value-chain distortions.

Aside from these impacts from the main policy considerations, coordination of sectoral taxes more broadly was considered in terms of (i) ending of the derogation that currently allows several Member States to apply capital duties, and (ii) a non-binding measure, such as a Commission Recommendation, to coordinate sectoral taxes. These would both be expected to further increase consistency and coherence of taxation, albeit to a limited extent. That said, while the non-binding measure on its own might have only a marginal influence on Member States' behaviour, if it proves insufficient at addressing fragmentation then it could set the stage for more extensive in the future.

The table below summarises the impacts of each policy consideration and variant. The impacts are each scored compared to the dynamic baseline on a five-point qualitative scale, from ++ to --, with ++ being very positive and -- being very negative; 0 means no or neutral impacts, rather than an impact of exactly zero from a quantitative or economic perspective[693].

Table 96. Policy comparison: Block 3

Policy consider-ation	Impacts on sales and VAT revenues and the wider economy; social impacts	Impacts on legal certainty	Impacts on regulatory costs	Market impacts
3A	3A(i)a: sales +, govt revenues -- 3A(i)b: sales -, govt revenues ++ 3A(ii): sales: 0, govt revenues 0	0/+	+/++	+/++
	The impacts on sales and government revenues move in opposite directions and differ depending on the VAT rate used and whether sectoral taxes are removed or retained, with impacts revenues being more pronounced overall: - 3A(i)a: EUR 13 bn on sales, EUR – 41 bn on govt revenues - 3A(i)b: EUR -11 bn on sales, EUR 30 bn on govt revenues - 3A(ii): overall impact of 0 on both sales and revenues. Impacts also differ by sector: - For banking, sales impacts are essentially neutral for all three variants, while revenue increases under 3A(i)b and falls slightly for 3A(i)a and 3A(ii). - For insurance, the prominence of IPTs and whether they are removed strongly influences the results: sales increase slightly under 3A(i)a, fall slightly under 3A(i)b or remain unchanged under 3A(ii), while revenues fall substantially under 3A(i)a, increase substantially under 3A(i)b, or increase modestly under 3A(ii).	Removing the exemption entirely would eliminate the existing problems, but also create new ones, particularly from the difficulty of applying VAT to interest-based services.	Offers considerable simplification potential that translates into reduced administrative costs, but these are partly offset by new obligations. Overall, savings of EUR 50m to 1.3bn could be expected, depending on removal of sectoral taxes.	Removing the exemption would restore the right of deduction and thereby fully level the playing field between in-house and groupsourced / outsourced production. Reduced divergence across MS would also make it easier to trade in the Single Market and support competitiveness, without creating unfair advantages for certain types of firms or jurisdictions in or outside the EU. However, taxing interest-based services would introduce a new distortion, unless addressed by taxing interest

[693] For block 3, impacts on sales and government revenues are assessed separately. In both cases, increases are assessed as broadly positive, while decreases are negative.

	- For other financial services, the high share of B2B supplies leads to increased sales and drops in revenues for all variants, due to the restored right of deduction for service providers. The macroeconomic impacts are limited once revenue impacts are recycled into the economy, with near-neutral GDP impacts, improvements to the trade balance and small (positive or negative, depending on the variant and recycling method) impacts on household consumption and employment. Risks to access to basic services from increased costs are low, and if deemed necessary could be offset by retaining the VAT exemption for these services.			revenues, but this would also partly erode tax neutrality.
3B	3A(i)a: sales +, govt revenues -- 3A(i)b: sales -, govt revenues +/++ 3A(ii): sales: 0, govt revenues 0	+/++	+/++	+/++
	The dynamics at play are very similar to 3A across all three variants, with the exception that the exemption would be retained for interest-based services in the banking sector. As such, the impacts in this sector would be less pronounced because the exemption would only be removed for a share of turnover (ca 27%). - 3B(i)a: EUR 15 bn on sales, EUR – 47 bn on govt revenues - 3B(i)b: EUR -7 bn on sales, EUR 19 bn on govt revenues - 3B(ii): overall impact of 0 on both sales and EUR 1 bn on revenues. Similarly limited macroeconomic impacts are also expected, and very low risk to financial inclusion or access to basic services. Consumer credit would also be unaffected since interest-based services would remain exempt.	For insurance and other financial services, the impacts would be positive and as for 3A. The impacts would also be positive for the banking sector, since uncertainty regarding VAT treatment for the most problematic services would be resolved. However, the proportional deduction rules would still be needed, meaning the current issues therein would persist. Rules would also be needed to deal with grey areas between fee-and interest-based services.	Provides similar simplification potential and reductions in administrative costs to 3A. But since interest-based services would still be exempt, no savings or new obligations would be created. Overall, savings of EUR 105m to 885m could be expected.	For insurance and other financial services, the improvements to market functioning and trade would be similar to 3A. In banking, no new distortions would be introduced, but the existing issues of hidden VAT would persist for interest-based services, which comprises the majority of sectoral turnover.
3C	Sales: 0, govt revenues: 0	+/++	++	0/+
	The introduction of the FAT is used to balance the introduction of VAT zero-rating and removal of sectoral taxes, meaning that government revenues are neutral, albeit with considerable variation by sector. Only marginal impacts on sales are expected.	The relatively simple mechanism of the FAT, coupled with harmonisation of VAT treatment (zero-rating) and standardised removal of sectoral taxes would	Reducing the scope for divergence across MS and simplifying VAT treatment would result in considerable savings	The current distortions would be partly addressed by restoring the right of deduction, while reduced tax fragmentation would support

		constitute a considerable increase in consistency and legal certainty overall.	overall, estimated from EUR 920m to EUR 1.3 bn.	cross-border trade. However, since the FAT is not a fractionated tax, costs would remain invisible to customers and result in a non-neutral tax on inputs.

15. Overall conclusions

15.1 Overview

The study has examined the tax framework for the financial sector in the EU, with a view to figuring out if that framework causes challenges and, in that case, whether and how EU action could improve the situation. The issues at stake are serious – the financial sector is not only significant in size, accounting for over 4% of EU GDP and commensurate shares of other indicators, but of systemic importance. It touches virtually every aspect of the economy, serving as the backbone of investment, savings, payments, and risk management activities, and touching every economic operator and citizen in the EU. As such, any potential changes to the tax framework for the sector would have far-reaching effects, requiring solid evidence and careful consideration.

At the core of the study is the VAT exemption for financial services. This was originally introduced in the 1970s along with the EU VAT system, and stems from the technical difficulty of defining the tax base for services priced in interest rate spreads and other implicit charges. The exemption stipulates that, instead of charging VAT on outputs and deducting the VAT on inputs as with the normal VAT rules, outputs are VAT-free and providers of financial services cannot deduct the VAT on associated input costs.

While justified on the technical grounds, this departs from the fundamental principle and key strength of the VAT system that it should be neutral vis-à-vis production chains[694]. This is turn distorts behaviour by generating non-deductible 'hidden' VAT on inputs, thereby incentivising in-house production over outsourcing. It also artificially inflates prices of financial services for business customers making taxable supplies (due to the embedded hidden VAT), while reducing prices for private consumers and other business customers (since VAT is not levied on the last stage of production).

The exemption system also causes cascading problems. These include regulatory uncertainty and complexity (since implementing the exemption requires a range of specialised provisions), the sprouting of other taxes to offset the fiscal effects of the exemption, and knock-on effects in terms of compliance costs and difficulties, tax fragmentation in the EU, disincentives for financial services providers to invest in innovative services and hindered trade in the Single Market and competitiveness. The gradual shift in business practices – driven by technological change – towards specialisation and niche providers has served only to increase the scale of the problems, while the drive to integrate the EU Single Market has made them more acute. Meanwhile, digitalisation has also vastly improved systems for tax administration and compliance, lowering the practical barriers to applying VAT to the sector.

Against this backdrop, **the study has sought to answer essentially two questions**. First, is the VAT exemption still a necessary 'medicine' to manage the symptoms brought about by the financial sector's unique character and features? And second, if the exemption is no longer fully necessary, would removing it represent an improvement, or would the side effects be such that the cure is worse than the original disease? The study shed light on these questions by setting out the nature and magnitude of the problems caused by the exemption and fragmented sectoral tax framework, defining objectives and concrete policy considerations that could address these, and assessing their likely impacts based on a range of research methods, including sophisticated economic models, and extensive stakeholder consultation. While any decisions on whether and what kind of action should be taken are inherently political and beyond the scope of the study, it provides detailed evidence on both questions that may inform policymaking in the future.

Starting with the continued need for the exemption, several overarching conclusions can be drawn, namely:

- **The VAT exemption and sectoral tax framework for financial services have become firmly embedded in the tax system.** Regardless of the exemption's continued validity or not of its

[694] Put another way, "Exemption is anathema to the logic of the VAT. It breaks the chain of tax and offsetting credit, leading to distortions of production patterns since taxes on produced outputs cannot be reclaimed", cf. Adam, S et al. (2011). *Tax by design*. Oxford: Oxford University Press, available online at: Tax by design | Institute for Fiscal Studies. (last accessed March 2026).

original rationale and many shortcomings, stakeholders have learned to live with it and developed their business models and compliance infrastructure around accordingly. Tax authorities are also accustomed to the combined effects of the VAT exemption and sectoral taxes, which in some cases (e.g., IPTs in the insurance sector) sometimes result in higher tax revenues compared to the standard VAT framework. This creates a kind of path-dependency, whereby stakeholders prefer the current flawed, yet predictable, system to future reforms that could make them better or worse off depending on details over which they would have little control.

- Nonetheless, **the problems caused by the VAT exemption and tax framework are worse than they were in previous decades**, when full-service business models based on in-house production and (nearly) fully domestic markets were the norm. The economy-wide trend towards specialised suppliers and the outsourcing (or, within corporate groups, groupsourcing) of input supplies increases the prevalence and severity of tax-driven distortions and adverse effects on business decisions. Meanwhile, even if other (regulatory, cultural) factors play a greater role in hampering cross-border trade and the competitiveness of the EU financial sector, the tax framework does pose barriers that cannot be ignored in an economy that purports prioritise integration and growth.
- **As for the continued validity of the technical rationale for the VAT exemption, this remains valid only to a partial extent**. When it comes to services remunerated in fees and commissions – which are the norm in insurance and other financial services, as well as a sizeable portion of the banking sector – VAT could be applied to these relatively easily. This is evidenced by the nine EU Member States allowing providers the option of taxing (certain) financial services, as well as most of the third countries examined for the study that apply VAT to at least parts of the sector. The study also developed and assessed in depth policy considerations that would involve taxing fee-based services and found that they could be implemented smoothly and even reduce administrative costs for compliance.
    - In contrast, **applying VAT to interest-based services is feasible but remains challenging**. Several conceptual methods have been developed for doing this, including taxing the gross interest, taxing the interest margin minus an average loss provision, and taxing net revenues. However, all of these suffer from certain weaknesses. The first is relatively simple to implement but overstates added value. The second would be complicated to implement, because it would rely on proxies rather than real values for the net interest margin and loss provision; while also creating serious risks for the transmission of monetary policy into banking systems. The third method entails taxing net revenues. It is the only method being applied at scale in a comparable VAT system to the EU and would be relatively simple to implement. However, it would depart from the transaction-based, fractionated character of VAT, meaning it would not fully provide for VAT neutrality, and resemble a turnover tax or Financial Activities Tax (FAT) more than VAT. The methods identified would also all be unable to incorporate input VAT on deposits (despite this being a major source of financing for banks).

The **assessment of the impacts of the policy considerations provides insight for the second question**, on the types of action that could be taken and how they would compare with the status quo. The **considerations fall into the three 'building blocks'** that were assessed in the foregoing chapters. The first two of these would work within the existing VAT exemption framework and entail either modernisation and simplifications; or measures to reduce hidden VAT (as the main driver of market distortions caused by the tax framework); the third building block consists of fundamental reforms to the VAT exemption and other aspects of the tax framework.

As mentioned, **decisions on future action are inherently political and depend on the priorities of policymakers**. All types of action assessed entail different costs and benefits that would need to be weighed carefully. However, while the number of policy considerations (and variants therein) examined are high in number, the broad contours of their main strengths and weaknesses can be distilled into three main themes, namely:

- **Incremental improvements**: the functioning of the VAT exemption could be improved, generating real benefits like a more level playing field between Member States, more legal certainty, and reductions in administrative costs. Action of this nature includes the modernisation of the definitions (consideration 1A) and 'stricter' variants of considerations 1B (mandating or allowing a

fixed rate of deduction at average rates), 2A (extending VAT grouping to all Member States) and 2B (the narrow, entity-level option to tax), which would simplify and harmonise the use of structural provisions while only reducing to a limited extent the amount of hidden VAT that could be avoided with their use. Such measures might well be worth considering, especially given the limited disruption that they would cause. However, since the changes would not address the underlying distortions or restore VAT neutrality, the more structural problems would remain. In other words, incremental improvements can be thought of as relatively low-risk, low reward.

- **Measures to significantly reduce hidden VAT within the VAT exemption framework**: while hidden VAT appears as an inescapable feature of the exemption framework, in fact the scale of the problem can be significantly reduced by making it easier for providers of financial services to deduct the VAT incurred on inputs. This is a common feature of several measures considered, such as the super deduction approaches to the fixed rate of deduction in consideration 1B, the cross-border VAT grouping and re-establishment of cost-sharing arrangements in consideration 2A, and the transaction-based approach to the option to tax in consideration 2B. However, these types of action all come with the trade-off of significant drops in VAT revenues. This is unavoidable if outputs remain exempt, since hidden VAT is the main source of VAT revenues in the sector.
- **Fundamental reforms to the taxation framework**: the measures in Block C would address the existing problems by applying VAT to financial services – fully or partly (i.e. for fee-based services only) - or by zero-rating financial supplies and taxing the financial sector through a Financial Activities Tax (FAT, meaning a tax on the profits and remuneration of financial services providers). These approaches would restore the right of deduction and thereby VAT neutrality, while (for the measures applying positive VAT to financial services outputs) shifting the main source of VAT revenues from the financial sector from inputs to outputs. This would bring financial services more into line with other sectors of the economy, creating clear benefits in terms of VAT neutrality and simplification. However, the drawbacks are also clear, in the form of new practical difficulties, especially if VAT is applied to interest-based services, and disruption while stakeholders adjusted to the new system. The coordination challenges would also be formidable, given the path-dependency described above. That said, with sufficient political will, such reforms would be feasible and potentially advantageous.

The next section brings the report to a close by examining the likely effectiveness of the policy considerations in terms of the objectives defined in Chapter 10. Rather than the policy considerations already discussed individually, the focus is on fully fledged 'packages' formed of one or more considerations that could form a coherent policy initiative. Broadly six packages could be envisaged, which are outlined in the next section then discussed in terms of each policy objective.

15.2 Policy packages and their impacts and implications

Several fully-fledged policy packages could be envisaged, ranging from minor refinements to the existing VAT exemption framework (package 1), to changes that, while leaving the exemption in place, would reform it more substantially in line with different potential priorities (packages 2 and 3), to fundamental reforms based on either fully or partially removing the VAT exemption, or taxing the financial sector by means of a FAT instead (packages 4-6). Importantly, the purpose of this exercise is not to assess the implications of every set of policy considerations that would not be mutually exclusive. Rather, it is to illustrate the nature of the main choices at hand and the trade-offs inherent in different approaches, and thereby provide useful insight for future policymaking[695].

As with the impacts of the policy considerations, the packages are scored for each objective compared to the dynamic baseline on a five-point qualitative scale, from ++ to --, with ++ being very positive and -- being very negative; 0 means no or neutral impacts.

[695] It is also noteworthy that packages 1, 2 and 3 could also be combined with further soft coordination of sectoral taxes (which is not needed for packages 4, 5 and 6 which would remove these), and the removal of the derogation to the Capital Duty Directive that allows several Member States to retain such duties.

15.2.1 Package 1: Incremental improvements to the VAT exemption framework

Policy considerations included:

- 1A. Modernisation of the service definitions
- 1B(i). Simplification of the deduction rules

Rationale and key features: The study identified several aspects of the VAT exemption that cause problems for stakeholders but that could be addressed without substantial disruption in terms of the basic functioning of the exemption or tax liabilities incurred. This package would address some of these issues by updating outdated service definitions, and streamlining the rules for proportional deduction, thereby reducing discrepancies between Member States and simplifying compliance.

Table 97. Impacts of policy package 1

Objective	Score	Main impacts and implications
Specific objective 1. Put in place a coherent, stable and clear legal framework for the taxation of the financial sector	0/+	Compared to the dynamic baseline, this package would represent a modest improvement in terms of this objective. It would remove a degree of uncertainty regarding the definitions, which have become obsolete for certain services, as well as for rules for proportional deduction. To a limited degree, this would ease compliance for service providers and enforcement for tax authorities.
Specific objective 2. Achieve a neutral tax system for the financial sector, in terms of business models, value chains and trading practices	0	The situation would remain essentially the same compared to the dynamic baseline, since this package would not resolve or reduce the problem of hidden VAT and the associated distortions to value chains.
General objective. Improve the functioning of the tax framework for the financial sector	0/+	Based on the contribution to specific objective 1, minor improvements to the functioning of the tax framework would be expected, at relatively limited cost in terms of disruption to existing systems and processes.

15.2.2 Package 2: Strict harmonisation of the VAT exemption framework

Policy considerations included:

- 1A. Modernisation of the service definitions
- 1B(ii). Introduction of a mandatory fixed rate of deduction at national average rates
- 2A(i). Mandatory introduction of VAT grouping
- 2B(i). Availability of the option to tax in all Member States on an entity-wide basis applied to a harmonised, narrow set of services

Rationale and key features: Variation in the application of the VAT exemption framework has been found to contribute to regulatory complexity and difficulties to trade in the Single Market. This package would prioritise harmonisation by reducing the scope for discretion at national level and streamlining application across the EU. While this would narrow the scope for divergence, it would do little to address reduce the underlying distortions caused by the exemption.

Table 98. Impacts of policy package 2

Objective	Score	Main impacts and implications
Specific objective 1. Put in place a coherent, stable and clear legal framework for the taxation of the financial sector	+	In addition to the benefits mentioned for package 1, this package would increase legal certainty and clarity meaningfully by introducing harmonised proportional deduction rules and an option to tax mechanism, as well as extending VAT groups to the few Member States not currently allowing them. This would considerably reduce the room for divergence between countries and simplify the application of the VAT exemption framework. Thanks to the mandatory fixed rate of deduction, administrative costs would also come down by EUR 135 to 450 million.
Specific objective 2. Achieve a neutral tax system for the financial sector, in terms of business models, value chains and trading practices	0/+	For providers of financial services in the five countries not currently allowing VAT groups, this package would allow for a meaningful reduction in hidden VAT, amounting to some EUR 570-670 million annually. The entity approach to the option to tax would reduce hidden VAT for some providers, though this relatively strict approach would limit its appeal and uptake, putting a ceiling on the benefits (overall, VAT revenue would increase by about EUR 0.6-2 billion). At the margin, increased harmonisation could also foster trade on the Single Market. In other respects, the VAT exemption framework would remain unchanged, meaning that the core problem of hidden VAT would persist for most providers of financial services.
General objective. Improve the functioning of the tax framework for the financial sector	+	This package would considerably reduce the scope of potential divergence between Member States and streamline its application, as well as reducing hidden VAT at the margins. This would improve the functioning of the tax framework overall without fundamentally altering the exemption.

15.2.3 Package 3: Flexible harmonisation of the VAT exemption framework

Policy considerations included:

- 1A. Modernisation of the service definitions
- 1B(iii). Optional fixed rate of deduction at a super deduction rate
- 2A(i and ii). Mandatory introduction of VAT grouping that could be used cross-border
- 2B(iv). Availability of the option to tax in all Member States on a transaction basis, applied to a harmonised, broad set of services

Rationale and key features: The core problem of the VAT exemption is that it breaks VAT neutrality by taxing inputs without the right of deduction, leading to hidden VAT on outputs. While this problem cannot be fully resolved while retaining the exemption, its scope can be significantly reduced through reforms that enhance the ability of financial services providers to reduce hidden VAT. This package combines a series of measures having this effect. The cost would be an increase in complexity, since providers would tailor approaches to individual needs, and reduced VAT revenue.

Table 99. Impacts of policy package 3

Objective	Score	Main impacts and implications
Specific objective 1. Put in place a coherent, stable and clear legal framework for the	0/+	This package would introduce a range of measures that would both harmonise the rules across Member States and increase flexibility for service providers.

taxation of the financial sector		While these measures would help providers reduce hidden VAT (see objective 2), the amount of variability – and legal difficulty of making VAT grouping available cross-border – would complicate compliance and enforcement, increasing costs and create areas of potential uncertainty. Thus, while optional fixed rate of deduction would bring down administrative costs by EUR 95 to 320 million, the complex nature of cross-border VAT groups and the transaction option to tax would create additional non-negligible (though not possible to quantify) administrative costs for service providers and enforcement costs for authorities.
Specific objective 2. Achieve a neutral tax system for the financial sector, in terms of business models, value chains and trading practices	+/++	This package would offer significant opportunities to reduce hidden VAT and the associated market distortions, from several angles:- the super deduction rate would bring down irrecoverable input VAT by ca EUR 29 billion; cross-border VAT grouping would promote groupsourcing (i.e., the centralisation of input supplies by corporate groups), leading to an estimated reduction of hidden VAT of ca EUR 9.1-10.6 billion; and high uptake of the transactional option to tax would allow financial institutions to apply VAT to taxable customers, reducing VAT revenues by almost EUR 12 billion. These estimates cannot simply be added together due to the risk of double-counting, but overall they represent a significant reduction in hidden VAT. This would meaningfully reduce the scope of distortions, going some way towards levelling the playing field and making it easier for firms to outsource and for specialist providers – in particular start-ups and SMEs – to compete.
General objective. Improve the functioning of the tax framework for the financial sector	+	This package illustrates the difficulty of striking a balance between the two specific objectives, as well as of reducing market distortions within the exemption framework while preserving government revenues – as shown, this package would entail significant drops in VAT revenues. For providers of financial services, the benefits of reduced disincentives to groupsourcing / outsourcing and lower VAT liabilities are likely to outweigh the costs of some uncertainty and administrative costs, but from the perspective of national budgets this would require careful consideration.

15.2.4 Package 4: Full removal of the VAT exemption and sectoral taxes

Policy considerations included:

- 3A(i)a. Removal of the VAT exemption and sectoral taxes for all financial services

Rationale and key features: The most conceptually pure policy consideration would be implemented on its own, since it would eliminate the VAT exemption altogether, as well as the sectoral taxes that have arisen in many cases to offset the exemption. Its main drawback would be the continued difficulty to apply VAT to interest-based services in the banking sector. It would also have important economic impacts.

Table 100. Impacts of policy package 4

Objective	Score	Main impacts and implications
Specific objective 1. Put in place a coherent, stable and clear legal framework for the taxation of the financial sector	0/+	Removing the exemption entirely would eliminate the existing problems, as well as simplifying compliance, for which administrative cost reductions of up to EUR 1.3 bn are estimated. However, the difficulty of applying VAT to interest-based services would generate new uncertainty and implementation difficulties.
Specific objective 2. Achieve a neutral tax	+/++	By removing the VAT exemption, this package would restore the right of deduction and thereby fully level the playing field between in-house and

system for the financial sector, in terms of business models, value chains and trading practices		groupsourced / outsourced production. Reduced divergence across MS would also make it easier to trade in the Single Market and support competitiveness, without new creating new problems in these areas. However, interest financing for banks would remain untaxed, creating a lingering distortion while, depending on the method chosen for taxing interest-based services, neutrality would either not be restored on a transaction basis for these services.
General objective. Improve the functioning of the tax framework for the financial sector	+	For insurance and other financial services, the benefits of this option in terms of improved functioning of the tax framework are clear, since these sectors are comprised of fee-based services to which VAT could be applied straightforwardly. The trade-off is more difficult to parse for the banking sector, since the benefits would be coupled with challenges in terms of the uncertainty and distorting effects of applying VAT to the interest-based services making up the majority (ca 73%) of sectoral output. While different approaches exist to overcoming these challenges, the most workable tax base (taxing interest margins on a periodic basis) would not be compatible with transactional VAT, meaning some of the neutrality issues with the exemption would remain. Since the removal of sectoral taxes and restored right of VAT deduction would more than offset the imposition of VAT on financial services outputs, the impacts would be positive on sales (estimated at EUR +13 bn) and negative on government revenues (estimated at EUR -41 bn). Impacts would also vary considerably by sector and market segment: the positive sales effect would be driven mainly by B2B transactions, while B2C impacts would remain broadly neutral overall. The macroeconomic impacts are modest and broadly favourable when the fiscal impact is recycled, with improved trade balances and limited effects on GDP and employment.

15.2.5 Package 5: Removal of the VAT exemption and sectoral taxes for fee-based services

Policy considerations included:

- 3B(i)a. Removal of the VAT exemption and sectoral taxes for fee-based services
- 1B(iii). Optional fixed rate of deduction at average rate
- 2A(i). Mandatory introduction of VAT grouping
- 2B(ii). Availability of the option to tax in all Member States on a transaction basis, applied to the interest-based services remaining exempt

Rationale and key features: By applying VAT to fee-based services, whose tax base can be determined straightforwardly, this policy choice would mirror the approach employed successfully in several third countries. In practice, this choice would only differ from the one above with regard to the banking sector, which would retain the exemption for interest-based services. Accompanying reforms would aim to streamline implementation for services remaining exempt.

Table 101. Impacts of policy package 5

Objective	Score	Main impacts and implications
Specific objective 1. Put in place a coherent, stable and clear legal framework for the	+/++	This package would combine the benefits for insurance and other financial services described in package 4 with less pronounced, but still considerable, improvements in the banking sector. For the latter, uncertainty regarding VAT treatment for the most problematic services would be resolved, since these are fee-based and would become taxed. Compliance would also be simplified, both from the removal of the exemption (savings of up to EUR 885

taxation of the financial sector		million expected) and availability of the fixed rate of deduction for the banks still supplying exempt services. This would also allow service providers to avoid the complexity needed to calculate the proportional deduction rate, though rules would still be needed to deal with the grey areas between fee- and interest-based services.
Specific objective 2. Achieve a neutral tax system for the financial sector, in terms of business models, value chains and trading practices	+/++	For insurance and other financial services, and the fee-based segment of the banking sector, the benefits would be major, in line with those described for package 4. For the market segment remaining exempt (i.e., interest-based services), the existing issues of hidden VAT would persist, but could be tackled via the option to tax.
General objective. Improve the functioning of the tax framework for the financial sector	+/++	This package offers a potentially workable compromise that would remove the VAT exemption and the associated problems for a large proportion of the sector, while retaining it as a 'necessary evil' for interest-based services. Such an approach would represent a substantial improvement on the current situation, in terms of legal certainty and clarity, the level of tax fragmentation, market functioning and removing barriers to innovation, trade and competitiveness. The economic impacts from removing the VAT exemption and sectoral taxes would also be similar to package 4: an increase in sales of EUR +15 bn combined with a drop in government revenues of EUR -47 billion, with considerable variation by sector and market segment. The considerable revenue reduction is due to the application of VAT to financial services outputs only partially compensating for the right of providers to deduct input VAT and the removal of sectoral taxes. As with package 4, the macroeconomic impacts are also modest and broadly favourable when the fiscal impact is recycled.

15.2.6 Package 6: Introduction of a Financial Activities Tax (FAT) for all financial services, with VAT zero-rating and removal of sectoral taxes

Policy considerations included:

- 3C. Introduction of an FAT for all financial services, with VAT zero-rating and removal of sectoral taxes

Rationale and key features: In contrast with policy choices 4 and 5, this choice would aim to increase simplicity and coherence in the tax framework, and reduce distortions, by replacing VAT and sectoral taxes with an FAT. Such a tax is relatively simple to implement and, since a revenue-neutral rate was tested, would not have major immediate economic effects. However, since it would be embedded in suppliers' costs, it would not fully address the existing distortions.

Table 102. Impacts of policy package 6

Objective	Score	Main impacts and implications
Specific objective 1. Put in place a coherent, stable and clear legal framework for the taxation of the financial sector	+/++	The relatively simple mechanism of the FAT, coupled with harmonisation of VAT treatment (zero-rating) and standardised removal of sectoral taxes would constitute a considerable increase in consistency and legal certainty overall. Reducing the scope for divergence across MS and simplifying VAT treatment would result in considerable savings overall, estimated at up to 1.3 bn.

Specific objective 2. Achieve a neutral tax system for the financial sector, in terms of business models, value chains and trading practices	0/+	The current distortions would be partly addressed by restoring the right of deduction, while reduced tax fragmentation would support cross-border trade. The main downside is that, since the FAT is not a fractionated tax, costs would remain invisible to customers and result in a non-neutral tax on inputs. This would continue to distort market behaviour to a certain extent, particularly for the financial services providers purchasing financial services outputs as intermediate supplies.
General objective. Improve the functioning of the tax framework for the financial sector	+	The FAT presents an interesting proposition as that would replace the indisputably complex and costly VAT exemption with a 'clean slate', encapsulated in a relatively simple tax mechanism. From an implementation perspective, it appears workable. However, it would entail a massive disruption from the current system, while only partly alleviating the problems for tax neutrality. Moreover, these problems would be intractable in an FAT system. This could make it difficult to justify such a fundamental change, compared to the fee-based removal of the exemption in package 4, or the more incremental approaches. Since only a revenue-neutral VAT rate was tested with this option, the economic impacts would be relatively muted.

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